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IN THE

Supreme Court of the United States

October Term, 1973

R. D. TIMPANY, TRUSTEE IN REORGANIZATION OF THE PROPERTY OF THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Petitioner,

v.

STATE OF NEW JERSEY, COMMONWEALTH OF PENNSYLVANIA and PENNSYLVANIA PUBLIC UTILITIES COMMISSION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

STANLEY WEISS, ESQ.
744 Broad Street
Newark, New Jersey 07102

Attorney for Petitioner R. D. Timpany, Trustee of the Property of The Central Railroad Company of New Jersey

HEATHER MULLETT
On the Brief

RICHARD B. WACHENFELD
1100 Raymond Boulevard
Newark, New Jersey 07102
Of Counsel

November, 1973

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In the

Supreme Court of the United States

October Term, 1973

R. D. Timpany, Trustee in Reorganization of the Property of the Central Railroad Company of New Jersey,

Petitioner,

v.

State of New Jersey, Commonwealth of Pennsylvania and Pennsylvania Public Utilities Commission,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner, R. D. Timpany, Trustee in Reorganization of the Property of The Central Railroad Company of New Jersey, respectfully prays that a writ of certiorari issue to review the judgments and opinions of the United States Court of Appeals for the Third Circuit entered in this proceeding on August 27, 1973 and October 3, 1973.

Opinions Below

Order No. 547 entered by the Reorganization Court for The Central Railroad Company of New Jersey (CNJ) on December 20, 1972 is not reported. (App. 1a-2a). It was based upon an oral opinion delivered on December 18, 1972, which opinion is not reported. (App. 3a-10a). Order No.

547 was affirmed by the United States Court of Appeals for the Third Circuit by judgment and opinion entered on March 7, 1973, which are not reported. (App. 18a-22a). This judgment of the Court of Appeals was vacated and a petition for a rehearing in banc granted by orders entered on March 26, 1973 which are not reported. (App. 23a-24a). On August 27, 1973 the Court of Appeals entered judgment reversing Order No. 547 and remanding the cause for further proceedings; majority and dissenting opinions were filed on the same date; and the judgment and opinions are not reported. (App. 25a-68a). On October 3, 1973 the Court of Appeals entered an order denying a further rehearing in banc sought by Petitioner, which order is not reported. (App. 69a-70a).

Jurisdiction

Petitioner seeks review of the judgment of the Court of Appeals entered on August 27, 1973 and of the order of October 3, 1973 denying his petition for rehearing. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1) and 2101(c).

Questions Presented

1. Whether the constitutional rights of a deficit-ridden, negative net worth railroad in reorganization are violated when it is compelled to operate passenger services in which it currently incurs losses in excess of its annual system deficit even if the rights of its bondholders have not been unconstitutionally taken.

2. Whether a Reorganization Court can order a termination of unprofitable passenger services of a freight and passenger railroad in reorganization in order to stop losses,

protect the debtor's constitutional rights, and further the reasonable prospects of successful reorganization.

3. Whether *Palmer* v. *Massachusetts*, 308 U.S. 79 (1939), in view of subsequent statutory and economic developments, deprives a reorganization court of power to hear and decide a petition for intrastate service discontinuance where the state involved does not object to the use of the reorganization court as the forum and has enacted legislation authorizing public compensation for the full cost of such service.

Statutes and Constitutional Provisions Involved

The constitutional provisions involved are Amendment Five and Amendment Fourteen, Section 1. The statutes involved are Section 77(a), (c)(3), and (l), 11 U.S.C. 205(a), (c)(3), and (l); Interstate Commerce Act Section 13a(2), 49 U.S.C. 13a(2); New Jersey Transportation Act of 1966, N.J.S.A. 27:1A-16, 17, 18, 20, 21, 22, 23, 24; and N.J.S.A. 48:2-24. These constitutional and statutory provisions are set forth in Appendix B.

Statement of the Case

This Petition seeks review of a 6-2 decision of the Banc, reversing Order No. 547 of the Reorganization Court, which Order had been affirmed unanimously by a three judge Panel of the Third Circuit.[1] Order No. 547 directed the cessation of unprofitable passenger services which Petitioner claimed was unconstitutionally taking the Debtor's property. Respondents sought a rehearing in banc, arguing that *Palmer* v. *Massachusetts*, 308 U.S. 79 (1939) controlled the matter; and the rehearing was granted without

[1] Two of the three members of the Panel did not sit on the Banc.

the ordinary request by the Court for an Answer (Fed.R. App.P. 40(a)). In reversing, the Banc concluded that the operation of CNJ's passenger service was not *yet* causing an unconstitutional taking of the Debtor's property, relying for this conclusion upon the construction of two of the Reorganization Court's opinions—one in the within matter and the other in connection with a prior hearing in which an application of the Debtor's bondholders for the cessation of all of the Debtor's freight and passenger operations was denied without prejudice. Petitioner had no opportunity to be heard before the Banc on the issues involved in this conclusion.

The CNJ is a freight and passenger rail carrier which has been in reorganization in the United States District Court for the District of New Jersey under §77 of the Bankruptcy Act since March 22, 1967. It also had been in reorganization in the 1940's and has incurred substantial annual deficits in every year of operation since 1958. In the 1958-1972 period it lost well over $100,000,000; and its annual deficits from operations have been in the $7,000,000-$15,000,000 range during the 1967-1972 period of reorganization. Its books at December 31, 1972 reflect total assets of $111,700,000 and a deficit in its net worth account of $18,600,000.

CNJ's passenger operation is extremely unprofitable and was shown below to be the cause of CNJ's continuing deficit in overall operations. At the time of the hearing before the Reorganization Court, CNJ provided passenger service under a contract with the State of New Jersey, acting through its Commuter Operating Agency, calling for a subsidy in the amount of $5,097,591 for the fiscal year July 1, 1972–June 30, 1973[2] (Appendix upon appeal to the

[2] Petitioner testified that he had executed the contract in order to obtain a cash advance which was needed to meet a critical cash shortage. (Appendix upon appeal to Third Circuit, at p. 146a).

Third Circuit, at p. 18a). That amount was the State's determination of CNJ's "avoidable cost" in operating such service during the calendar year 1971. The subsidy was not adequate to compensate for the losses. The proofs showed that CNJ was incurring an uncompensated annual avoidable loss of $2,772,000 (based upon the current wage and price levels) and that uncompensated losses on a full cost of service basis exceeded $500,000 a month at that time.

Historically, regulation of CNJ's passenger service was entrusted to New Jersey's Public Utility Commission [N.J. S.A. 48:2-21, *et seq.*]. Railroads, seeking to discontinue unprofitable operations, would be heard in a quasi judicial proceeding in which the losses to be saved would be balanced against the disruption to the public involved in the discontinuance. However, in the 1960's, the State of New Jersey, recognizing the unprofitable nature of passenger operations, changed its public policy to provide for subsidies for passenger service. It established the Commuter Operating Agency (COA) within the Department of Transportation consisting of the Commissioner of Transportation, the Assistant Commissioner of Transportation, the State Treasurer and the President of the Public Utility Board of Commissioners; and the regulation of railroads receiving financial subsidies was transferred to the COA (N.J.S.A. 27:1A-15, *et seq.*). The COA is required to annually investigate and determine the financial results of each carrier's passenger service and of the action required to offset all or part of the losses incurred therein, including changes in service and subsidy levels.[3] The subsidy contract is negotiated with and executed by the COA; and the contract must provide the carrier with the right to

[3] The subsidy contract forming the subject matter of the hearing below indicates that it is the product of this administrative investigation and determination. (Appendix upon appeal to the Third Circuit, at p. 14a).

petition the COA for changes in passenger service including abandonments in whole or in part (N.J.S.A. 27:1A-24). While railroads not receiving subsidies are explicitly prohibited by statute from abandoning service without Public Utility Commission approval (N.J.S.A. 48:2-24), no similar prohibition appears in the COA legislation.

In July of 1972 the New Jersey Legislature amended N.J.S.A. 27:1A-18 to permit the COA to compensate carriers for the full cost of providing passenger service rather than merely on an avoidable loss basis and on a current rather than on a reimbursement basis, stating in the Introductory Statement to the bill that it was likely that such a basis for compensation would become the standard required by the courts as a prerequisite for allowing railroads in reorganization to continue to provide passenger service. (App. 85a-87a).

Petitioner assumed his duties as Trustee in January of 1971; and two of the programs he adopted for the CNJ were to shrink its freight configuration (primarily by abandoning its Pennsylvania operations) and to seek a full cost of service contract from the State of New Jersey for the operation of CNJ's passenger services. The Pennsylvania freight operations were abandoned in 1972 by virtue of a reorganization court Order No. 445, aff. *In the Matter of The Central R. Co. of N.J.*, 455 F.2d 989 (3d Cir. 1972), cert. den. 409 U.S. 889 (1972) and a subsequent May 26, 1972 Order of the ICC on CNJ's abandonment application in which the ICC determined that CNJ was *"in extremis"* requiring "drastic remedial action". (*Central Railroad Company of New Jersey — Abandonment*, 342 I.C.C. 277, at 288 (1972). As for the passenger service, Petitioner testified at the trial below to continuous negotiations with the Chairman of the COA and other officials over a protracted period of time and to the futility and

frustration encountered. (Appendix filed upon appeal to Third Circuit, at pp. 144a-151a; 222a; 293a-295a). His testimony indicates that when continued negotiations appeared futile, the Chairman of the COA suggested that an application raising the issues between the parties should be filed with the Reorganization Court. (Appendix filed upon appeal to Third Circuit at p. 146a).

On November 22, 1972 Petitioner filed an application with the Reorganization Court seeking authority to terminate the existing subsidy contract and thereupon to terminate all passenger service unless the State of New Jersey entered into a full cost of service passenger subsidy agreement. Paragraph Seventeenth of the subsidy contract gave to each party the right of termination upon 30 days' notice effective after the application by the railroad of advance payments (the notice period) (Appendix on appeal to the Third Circuit at p. 25a); and since termination carried with it the cessation of all subsidy payments (here, approximately $5,000,000 for the year), Petitioner also sought authority to cease providing passenger service unless the State of New Jersey agreed to pay for it.

Prior to the filing of Petitioner's application, the CNJ bondholders had filed an application for the cessation of all rail services of the Debtor, claiming that continued operations involved an unconstitutional taking of bondholder property. Petitioner, in opposing the application, focused upon the distinction between the bondholders' constitutional rights and the Debtor's. The bondholders had the contractual right to foreclose on the collateral; and the Debtor owned its property, which Petitioner held for the benefit of all creditors (including those subordinate to the bondholders) and shareholders. The constitutional issue for the bondholders was whether the stay of their foreclo-

sure right was unreasonable in view of the Debtor's prospects for reorganization; and the constitutional issue for the Debtor was whether, in view of the Debtor's financial circumstances, its property was being consumed without compensation in hopelessly unprofitable public services. Petitioner claimed that he, not the bondholders, had standing to complain of the latter since the bondholders could not show that the value of the collateral would be insufficient to satisfy the debt to them and prior claimants. Petitioner contended that a resolution of the passenger problem would restore profitability to the Debtor's operations and justify a continued stay of the bondholders' contractual rights of foreclosure.

The trial on the bondholders' application was held during the week of December 4, 1972; and the trial on the Trustee's passenger application was held during the week of December 11, 1972. Respondents here are party intervenors in the CNJ reorganization proceeding; and the hearing on the bondholders' application focused in depth on proofs also introduced at the subsequent hearing on the Trustee's application. One of the exhibits at both hearings showed that the receipt by CNJ of a fully compensatory passenger subsidy contract would convert a substantial loss in total operations to a profit; and Petitioner contended and later proved that CNJ could operate at a profit if its passenger service were dropped and it continued on as a freight carrier. The Court, noting various improvements in the bondholders' collateral position[4], denied their application without prejudice to its renewal, obviously considering that a decision as to the propriety of continued operation was premature until a determina-

[4] The Trustee had settled on a favorable basis a substantial administration claim, prior in right to the bondholders' claim, and had improved the value of the property in a number of respects.

tion was made of the passenger service dispute. (App. 17a).

At the hearing on the passenger service dispute, which had been invited by the Chairman of the COA, the State of New Jersey did not in any way challenge the power or propriety of the Reorganization Court's deciding the matters raised. There was no assertion of the primacy of New Jersey's regulatory authority or of its interest in its comity. Instead, both the Chairman and Secretary of the COA (two of its four members) submitted affidavits on the merits which in essence stated that the State coffers were bare, the CNJ's demands were excessive, the service was inadequate and the existence of the loss was unproven. A trial was held which focused primarily upon the size of the uncompensated loss. The Court found uncompensated losses of approximately $500,000 a month, that such losses were "eating into the very heart of this unfortunate carrier", and that unless there were full compensation, there would be an erosion of assets resulting in the unconstitutional taking of the Debtor's property. Order No. 547 was entered authorizing the termination of the subsidy contract after the running of the notice period and directing the Trustee to terminate passenger service unless the parties agreed during the notice period "to a mutually satisfactory arrangement for the continuation of such service". Shortly thereafter the New Jersey Department of Transportation issued a report which contained the following statement:

> "Complete collapse of The Central Railroad Company of New Jersey as an independent carrier with resultant disruption of its rail operations, both freight and passenger, appears to be inevitable without massively increasing financial public support".

The State of New Jersey appealed Order No. 547 (Docket No. 73-1006 in the Court of Appeals) as did the Commonwealth of Pennsylvania and its Public Utility Commission (Docket No. 73-1027), raising for the first time objections to the use of the Reorganization Court as the proper forum to hear and resolve the dispute. Their basic contention before the Panel was that the State administrative agency should first hear the constitutional and other issues raised in order to comport with statutory procedures.[5] No challenge was made of the determination that CNJ was incurring uncompensated losses of approximately $500,000 per month in its passenger operations. The Panel affirmed. Respondents filed petitions for rehearing in banc, arguing that the matters involved were of "exceptional public importance" not only because of CNJ's operations, but also because of the need for a definitive ruling to guide other reorganization courts and the various federal and state agencies involved in the northeast rail crisis. The rehearing was granted and the Banc reversed. Petitioner and Debtor's bondholders unsuccessfully sought further rehearings in banc. Interim arrangements have been reached to provide for continuation of the passenger service through June 30, 1974.

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[5] Contrary to the State's position, the ICC has recently held that it "is not the appropriate forum to raise an issue of unconstitutional taking of property without just compensation" and that such a matter "in the first instance should be brought before the Reorganization Court". (Preliminary Report of Interstate Commerce Commission in the Penn Central Transportation Company Reorganization, Finance Docket No. 26241, bearing Service Date October 1, 1973, at p. 80).

REASONS FOR GRANTING THE WRIT

POINT I

This Case Raises Important Unresolved Questions of Federal Law As to the Extent to Which the Property Rights of a Railroad in Reorganization Are Protected by the Fifth and Fourteenth Amendments of the United States Constitution As Well As the Proper Role of a Reorganization Court in Providing Such Protection.

The railroads in the northeast are in crisis; and the Bankruptcy Act, the Interstate Commerce Act and diverse State statutes are inadequate to deal with the crisis. Such statutes provide procedures for balancing the public's interest in continued rail service against the property interests of railroads which are being run profitably or can be run profitably with some debt readjustment. They were not designed, and do not provide adequate procedures, to resolve the current problems of northeast railroads—whose present operations result in negative cash flow and whose foreseeable future operations provide little reasoned basis to anticipate, without massive public support, successful reorganization. The application of existing statutory procedures to these circumstances has resulted in the dedication of private property (in major orders of magnitude, against the will and better judgment of the owners and managers of such property) to the purpose of providing unprofitable rail service to the public. While admittedly the case books are full of frivolous claims of confiscation, the private parties financing public rail service in the present crisis have been driven to the Constitution for the protection of their rights; and the genuine spectre of unconstitutional confiscation has emerged as a dominant issue in the northeast rail crisis.

This case presents a clear test of that issue. It is generally recognized that passenger operations are unprofitable and that their continuation is justified only by the public interest. The CNJ is a deficit-ridden[6] negative net worth[7] carrier which can little afford to absorb the $500,000 per month uncompensated loss it has been incurring in its passenger operations. The proofs below showed that CNJ's operations could be returned to profitability if either its passenger service were eliminated or if it were fully compensated for the losses incurred in such service. The prospects for successful reorganization implied in such a potentiality fully justify the continued stay of the bondholders' contractual foreclosure rights. Under these circumstances, the Reorganization Court, finding that continued passenger losses would be an unconstitutional taking of the Debtor's property, authorized the termination of CNJ's existing passenger contract upon the expiration of the applicable notice period; implored the parties, in the public interest, to negotiate during the running of the notice period for a fair compensatory arrangement; and directed the cessation of all passenger service if the State in effect concluded not to pay for it.

The Banc held that an unconstitutional taking had not yet been proven. We submit that if the above facts do not constitute an illegal taking, it is questionable whether such a taking can ever be shown and whether there is any vitality to the constitutional protection afforded railroads in reorganization.

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[6] It has lost money in every year of operations since 1957; and its annual losses in the 1967-1972 period were in the range of 6-14% per year of the total 1972 book value of its assets.

[7] Most of the carriers in reorganization have a substantial book net worth. CNJ is the only major carrier in reorganization with a deficit in its net worth account. Thus, from a book value analysis, creditor interests, and not shareholder interests, are primarily at risk and may require a different level of protection.

A. *The Banc Has Confused the Constitutional Rights of the Debtor With Those of Its Bondholders*

The fundamental substantive error committed by the Banc on the constitutional issue was its failure to recognize the distinction between the constitutional rights of the Debtor and the constitutional rights of the Debtor's bondholders. The issue before the Banc was the constitutional rights of the Debtor; but the Banc expressed "disquiet over the plight of the bondholders"—not of the Debtor—and read the Reorganization Court's earlier finding that the bondholders had not yet shown an unconstitutional taking of their property as proof that the Debtor had similarly failed. The Reorganization Court, in denying the bondholders' application for total service cessation, obviously considered that a decision as to the reasonableness and constitutionality of a continuing stay of the bondholders' foreclosure rights would be significantly affected by the determination to be made on Petitioner's passenger application, since the proofs showed that either a termination of the passenger service or full compensation for passenger losses would return the Debtor to profitability. Accordingly, he denied the bondholders' application without prejudice and explicitly invited them "to give a look at what happens on December 11 and then govern themselves accordingly". The three excerpts from this opinion relied upon by the Banc in its Appendix attached to footnote 42 (App. 43a) merely reflect the substantial progress the present administration of the estate has made, bolstering the bondholders' chances of collectibility on the debt by improvements to the collateral and reduction of substantial prior claims. It does not follow—as the Banc assumed—that because the bondholders' foreclosure rights have not been unconstitutionally delayed, the Debtor's property was not being unconstitutionally taken by the forced continued operation of its unprofitable passenger service. Apart from

the bondholders, there are other creditors subordinate to them and shareholders whose interests are being eroded monthly by the continued losses in passenger operations. The Banc's misunderstanding of the nature of the constitutional issue led to its seizing upon insignificant uses of the future tense in the Reorganization Court opinion on Petitioner's passenger application. The Court was not called upon to award damages for prior takings but to authorize *in futuro*, after the running of the appropriate notice period, the termination of a contract and passenger services; and two of the three excerpts relied upon by the Panel in its Appendix merely implore the parties to negotiate during the running of the notice period for a fully compensatory contract which would reconcile the private and public interests involved.

The Banc's controlling conclusion:

> "Instead our task is to apply the statute Congress has enacted unless such statute inexorably conflicts with the Constitution. The record in this case does not demonstrate that such conflict has happened here—at least, not as yet".

is contrary to the Reorganization Court's determinations as well as the indications of CNJ's plight given by the ICC and the State Department of Transportation, agencies of relevant expertise. While the error can in part be explained by the dearth of Supreme Court opinion discussing the nature of the constitutional rights of railroads in reorganization,[8] it is due in some measure to the inadequate

[8] Although the rights of secured creditors of such railroads have been generally discussed in *Continental Illinois Nat'l. Bank & Trust Co.* v. *Chicago, R.I. & P.R. Co.*, 294 U.S. 648 (1935), *New Haven Inclusion Cases*, 399 U.S. 392 (1970), and *Penn Central Merger Cases*, 389 U.S. 486 (1968), the ICC has recently commented on the lack of *any* court precedent (other than an unreported opinion

attention given by the Banc to the normal procedures for reaching a just result.[9] The Banc seized upon a passing

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in *In The Matter Of Boston & Maine Corporation*, No. 73-1069, 1st Cir., Aug. 23, 1973) shedding enlightenment as to the elements of erosion which form a significant part of the Debtor's claim here. (Preliminary Report of Interstate Commerce Commission in the Penn Central Transportation Company Reorganization, Finance Docket No. 26241, bearing Service Date October 1, 1973, at p. 82.) The First Circuit's analysis in the *Boston & Maine* proceeding of the relevance of the existence of a cushion to the bondholders' constitutional claims contains substantial similarities to Petitioner's position on this issue in the hearing on the bondholders' application below (*Boston & Maine Corporation, supra*, p. 6).

[9] We recognize the Banc's obvious concern for the enunciation of orderly procedures to govern railroad reorganizations in the Third Circuit and elsewhere which reflect the system's concern for federalism and need for the proper use of administrative expertise. However, we fear that such concern diverted the Banc from its primary task of reviewing determinations based upon the record to assure that justice has been done in the specific case. In support of this, we point out: (1) the Banc's opinion is largely devoted to either irrelevant or subsidiary issues (the matter that had actually been litigated in the Reorganization Court was dealt with in only the final two sentences of the penultimate paragraph of the opinion which seemed to conflict with the rest of the opinion and leaves the law in a confusing state); (2) the Banc's opinion responds to a number of arguments, attributed to the parties, which the parties never raised (*e.g.*, Petitioner never made the frivolous argument that the Banc could not re-examine precedents of earlier panels (App. 32a); Petitioner never contended that the State lacked the power to condition the grant of a charter upon the burden of providing passenger service (App. 39a) and states that if, in fact, CNJ's charter is so conditioned (a matter about which there is no evidence) the State would have the option, if it wished to exercise it and cut off the freight as well, to institute a proceeding for charter revocation in which the issues could be meaningfully litigated and discussed; New Jersey never challenged the forum below, arguing for an opportunity "to create a viable rail system essential to the economic life of the region" (App. 29a); and no one urged the applicability of §77(o), since CNJ is not here seeking the abandonment or sale of a line but merely the discontinuance of intrastate passenger service over a line, a subject which does not require ICC approval); (3) it ignored significant elements of the record below, particularly as they bore upon the applicability of *Palmer* to the within circumstances (*e.g.*, the Banc, in describing both Petitioner's application to the Reorgani-

footnote reference in one of Respondents' two petitions for rehearing and elevated it to the grounds of decision, *i.e.*, the asserted inadequacy of the record to show an unconstitutional taking—without the opportunity of Petitioner to be heard by the Banc on the matter. The appeal before the Panel had not centered on such issues and the petitions for rehearing were granted without any request for an Answer as is customary. Petitioner's oral argument was consumed by questions directed at other issues; and the first inkling the Petitioner had of the Banc's concern with the facts of record or the meaning of the two Reorganization Court opinions was upon reading the Banc's opinion. The opinion, however, fails to contain any discussion of the facts of record that explain the conclusion. Moreover, as is shown *infra*, the effect of the Banc's extension of *Palmer* to this case has foreclosed Petitioner's opportunity to prove in the Reorganization Court exceptions to the *Palmer* doctrine explicitly recognized in the course of that litigation, *Converse* v. *Massachusetts*, 101 F.2d 48 (2d Cir. 1939).

Issues of such widespread public importance, involving rights of constitutional magnitude, should receive a more thorough airing before decision than was given here; and this Court has reversed for similar procedural irregularity. *Lutcher & Moore Lumber Co.* v. *Knight*, 217 U.S. 257 (1910); *Saunders* v. *Shaw*, 244 U.S. 317 (1917). Moreover, parties who have seriously litigated questions of constitutional right are entitled to a greater discussion of the record and indication of the evidentiary foundation of the

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zaton Court and Order No. 547 (App. 31a), omits the references in both which leave up to the State the ultimate decision as to the continuation of passenger service; and it ignores the State's acceptance of the Reorganization Court as a forum and makes unsupported findings (App. 38a) contrary to uncontested proofs below as to Petitioner's efforts to obtain relief from the State and the futility of further efforts).

decision than was given here in the two-sentence conclusion of the Banc, *Kelley* v. *Everglades Drainage District*, 319 U.S. 415 (1943) (see especially n. 1 at p. 420); and future litigants and the rational development of the law require a more reasoned analysis of the meaning and scope of the constitutional rights of railroads in reorganization. We ask this Court to correct the error and fill the void left by the Banc's opinion.

B. *This Court Should Review the Appropriate Role of Reorganization Courts in Fashioning Remedies Consistent With the Purposes of §77 That Are Needed to Protect Constitutional Interests*

It is well established that where a carrier's overall operations are profitable or even marginally profitable, its right to terminate a particularly unprofitable service is not of constitutional magnitude and is determined by balancing the public's need for the service against the carrier's loss incurred in providing it. *Mississippi R. Comm.* v. *Mobil & Ohio R. Co.*, 244 U.S. 388 (1916); *Fort Smith Light & Traction Co.* v. *Bourland*, 267 U.S. 330 (1924). Different considerations are presented where the carrier is experiencing a system-wide loss in operations *Alabama Pub. Serv. Comm.* v. *Southern R. Co.*, 341 U.S. 341, 347 (1951); *Atlantic Coastline R. Co.* v. *North Carolina Corp. Comm.*, 206 U.S. 1, 19 (1907); and courts, to protect constitutional interests, clearly possess the power to permit a total cessation of the services of a deficit-ridden railroad without the approval of state or federal administrative agencies. *Brooks-Scanlon Co.* v. *R.R. Comm. of La.*, 251 U S. 396 (1920); *R.R. Comm.* v. *Eastern Texas R.R.*, 264 U.S. 79 (1924); *Bullock* v. *R.R. Comm. of Florida*, 254 U.S. 513 (1921). The Interstate Commerce Act, the Bankruptcy Act and state regulatory statutes "were not intended to override constitutional guarantees . . . , and would not be

effective if they had been". *N.Y., N.H. & H.R. Co., Bondholders Committee* v. *U.S.*, 289 F. Supp. 418, 441 (S.D.N.Y. 1968). Also see *In Re N.Y., N.H. & H.R. Co.*, 289 F. Supp. 451 (1968).

Reorganization courts have been given all of the powers contained in §77 and "all the powers, not inconsistent with this section, which a court of the United States would have had if it had appointed a receiver in equity of the property of the debtor for any purpose" §77(a). Section 77(l) gives to the Reorganization Court the same jurisdiction and powers a court of bankruptcy has. The basic purposes of §77 which should guide the Reorganization Court are to preserve an ongoing railroad in the public interest while conserving the Debtor's assets for the benefit of its creditors and shareholders *New Haven Inclusion Cases, supra,* at 431. Ideally, the public interest should be served without penalty to the private interests involved; and ideally major restructuring should take place in the context of a consideration of a plan of reorganization in which the functions of the Court and the ICC are harmoniously brigaded. But the ideal is unachievable under present circumstances which often require a choice between the public and private interests involved and the taking of interim, though major, steps to permit the survival of the railroad or to create conditions which permit the formulation and consideration of a *feasible* plan of reorganization.

This Court has not passed upon the appropriate role of reorganization courts under present circumstances to order partial cessations of service where such conduct is necessary both to protect the constitutional interests involved and to keep alive the "light at the end of the tunnel" which justifies the reorganization proceeding. The issue is a grave and perplexing one pervading all existing railroad reorganizations. A partial cessation involves a lesser incursion

upon the public interest and the traditional jurisdiction of the administrative agency than does the total cessation which the Court clearly has the power to decree; and it can be more consistent with the purposes of §77. On the other hand, the Court may be institutionally ill-equipped to make the fine distinctions required in "picking and choosing" which services should be continued, which terminated, and the effect of the foregoing on the national rail system. It may well be that the proper role is to equitably balance the varying elements—the severity of the losses in view of the overall financial condition of the carrier, the degree of public disruption, the importance of the discontinuance to the survival of the railroad and the reorganization proceedings, and the need for administrative expertise.[10] Such was the basic approach of *Crawford* v. *Duluth Street Ry. Co.*, 60 F.2d 212 (7th Cir. 1932), totally ignored by the Banc, where in order to save a street railroad in equity receivership the Court authorized the abandonment of a portion of the operations that was causing an overall system deficit over the objection of respective state and municipal authorities. This Court should grant certiorari to determine whether *Crawford* does not provide the appropriate approach for present-day reorganization courts.

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[10] In the within matter the losses are huge relative to CNJ's total assets and its negative net worth condition; the likelihood of public disruption is negligible since subsidies would be forthcoming if the public interest justified the service; the discontinuance (or fair compensation) would return a deficit-ridden carrier to profitability thereby assuring its survival and the success of the reorganization proceedings; and there is no realistic need for the application of the COA's passenger-oriented administrative expertise since the unprofitability of passenger operations is generally recognized and Petitioner's application, directed at all of its passenger services, does not raise questions of "picking and choosing".

POINT II

The Banc, in Extending *Palmer* v. *Massachusetts* to the Circumstances of This Case, Has Decided Important Questions of Federal Law Which Have Not Been But Should Be Settled by This Court.

In the proceedings leading up to *Palmer* v. *Massachusetts*, 308 U.S. 79 (1939) the trustee had originally applied to the Massachusetts Department of Public Utilities for leave to abandon a portion of its passenger service situated at 88 passenger stations on the lines of the debtor and two other railroads. Massachusetts had a standard regulatory statute looking toward adjudication of abandonment applications—not a subsidy-oriented statute looking toward negotiations between the railroad and the state for the payment of losses on services the state wished to maintain. After the Public Utilities Department had held 21 hearings and before it had acted, the trustee joined in an application to the Reorganization Court to abandon these services. The Commonwealth of Massachusetts promptly objected to the Reorganization Court's jurisdiction. The Reorganization Court overruled the objection; the matter was tried; and the Reorganization Court authorized the cessation while the State regulatory proceeding "was still in the process of orderly consideration". 308 U.S. 79, 83. The Supreme Court did not address the question of whether a violation of constitutional rights had been established so as to justify a deviation from the mandate of the otherwise applicable statutes. Applying strict rules of construction, the Supreme Court held that Congress, in enacting §77, did not intend district courts to override normal State regulatory power. It did not hold, however, that the State must exercise that power or that a Reorganization Court must necessarily abstain from exercising its powers to adjudicate where the State raises no objection. Where the

sovereign consents to the forum, considerations of comity are not presented and the types of frictions within our federal system, which the *Palmer* court was concerned with, are not created.

The Banc's application of *Palmer* to this case extends *Palmer* by raising considerations of comity to the level of subject matter jurisdiction and by ignoring the changes in circumstances and federal and state legislative developments in the intervening years.

A. *The Issue of Subject Matter Jurisdiction*

The State of New Jersey invited the use of the Reorganization Court as the forum for a determination of its dispute with the CNJ. Respondents first challenged the power of such forum to adjudicate on appeal—after going to the merits below and losing. We contend that, even absent genuine issues of constitutional confiscation, the Reorganization Court clearly had the power to adjudicate the issues raised by the Trustee's petition, though abstention in the exercise of such power may be appropriate when dictated by considerations of comity, timely asserted by the State. We have already noted that §§77(a) and (l) provide a statutory grant to the Reorganization Court to adjudicate the issues. Moreover, in analagous areas, it also has been held that whether a particular cessation constitutes an abandonment within the meaning of a regulatory statute is a threshold question for the courts, *Powell* v. *U.S.*, 300 U.S. 276 (1937), and that where such cessation results from supervening rights of third parties no statutory violation need be involved. *Zirn* v. *Hanover Bank*, 215 F.2d 63 (2d Cir. 1954); *City of Alexandria, La.* v. *Chicago R.I. & Pac. R. Co.*, 311 F.2d 7 (5th Cir. 1963).

The Banc's opinion suggests that while there was jurisdiction to hear the Petitioner's application, the jurisdiction

somehow evaporated when, according to the Banc, the Court found no unconstitutional taking. The power to hear and decide, statutorily granted, does not evaporate in diversity actions when it is proven that less than $10,000 is in controversy; and it does not evaporate as to pendent claims when the federal claim fails in its proof. It should not be held to have evaporated here.

The Banc, in disregarding the State's failure to object to the forum below, has converted considerations of comity to those of subject matter jurisdiction and procedurally prejudiced Petitioner here. The Circuit Court opinion in *Converse* suggests that the Reorganization Court could have ordered the discontinuances if it found that the deficits accumulating during the period of State administrative consideration would defeat a plan of reorganization or if it found that the State had abdicated its regulatory role or unreasonably delayed in exercising it. In the within matter a full record was not made on these points, for the State raised no objection below to the forum. However, the record that was made suggests that the COA had already acted in fulfilling its annual review responsibilities pursuant to N.J.S.A. 27:1A-17; and that further attempts to obtain relief from the State would have been fruitless.[11] Moreover, the holding of the Banc that "there having been no application made, there can be no showing that delay or frustration would be the inevitable result" is contrary to *In Re Chicago Rapid Transit Co.*, 196 F.2d 484, 489 (7th Cir. 1952) and unrealistically ignores the fact that the New Jersey statutory scheme for the resolution of such disputes is directed at negotiations which, in this case, broke down.

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[11] See Petitioner's testimony as to his protracted negotiations and the affidavits submitted in the Reorganization Court by the Chairman and Secretary of the COA in opposition to Petitioner's application which, colloquially summarized, state: "No way—forget it". (Appendix filed upon appeal to Third Circuit at pp. 44a-53a).

This Petition should be granted to review whether the *Palmer* doctrine should be extended to cases in which the states do not timely assert their regulatory authority. We contend that in view of the State's consent to the forum, the Reorganization Court was well within the bounds of its discretion when it decided the matter presented to it and that it should not have been reversed absent a clear showing of abuse. Abstention by a federal court in a matter properly before it has been narrowly limited to clear cases of comity or cases in which the federal interest is minimal or the federal court is not in a disadvantageous position to decide matters of state law, *Alabama Pub. Serv. Comm.* v. *Southern R. Co., supra,* at 360—circumstances not presented in the within matter.

B. *Intervening Changes in Statutory Law and Factual Circumstances*

The dissenting opinion below reviews why changes in the circumstances in which railroad presently find themselves and in state and federal statutes applicable to such railroads make *Palmer* inapplicable to the within matter. We adopt that analysis here; emphasize the development of subsidy-oriented statutes in the intervening years (present in our case but not in *Palmer*); and wish to add two further points. First, Congress in enacting 49 U.S.C. 13a(2) in 1958 explicitly invaded state prerogatives concerning intrastate passenger service discontinuances and thereby diluted much of the basis of the holding in *Palmer*. The second point is to underscore the extent to which reorganization courts inevitably under present conditions have the power to decide whether service shall be continued. Railroads in reorganization are today plagued with negative cash flow; and rail service cannot be continued without cash. In these circumstances reorganization courts are continually called upon to decide whether cash shall be made

available to permit continued operations. They decide whether to permit the issuance of trustee's certificates, pursuant to §77(c)(3), to, *e.g.*, take advantage of the federal guarantees provided under the Emergency Rail Service Act of 1970 or whether to permit the railroad to utilize funds necessary for continued operations in special or capital accounts within carefully circumscribed standards. *The Central Railroad Company of New Jersey* v. *Manufacturers Hanover Trust Company*, 421 F.2d 604 (3d Cir. 1970); cf. *In Re Third Avenue Transit Corp.*, 198 F.2d 703 (2d Cir. 1953); and they decide whether to authorize or approve various contracts required for continued operation such as labor contracts or passenger subsidy contracts.

The blunt fact is that the Reorganization Court does control whether operations shall continue in the extenuating circumstances of the northeast rail crisis. The Banc's opinion clashes with this reality and provides confusion rather than clarity to guide the administration of railroad reorganization proceedings in these difficult times. As the dissenting opinion suggests, the CNJ facts cry out for action, not for an exercise in logomachy—and we might add—particularly an erroneous one. We urge this Court to review *Palmer's* applicability to present-day circumstances.

CONCLUSION

For these reasons, the Court should issue a writ of certiorari to review the judgments and opinions of the Third Circuit.

Respectfully submitted,

STANLEY WEISS, ESQ.
744 Broad Street
Newark, New Jersey 07102

Attorney for R. D. Timpany, Trustee of the Property of The Central Railroad Company of New Jersey

November, 1973

APPENDICES

APPENDIX A

Order No. 547 Authorizing the Trustee to Cancel Passenger Contract and Discontinue Passenger Operations

(Filed December 20, 1972)

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW JERSEY

In Proceedings for the Reorganization of a Railroad

No. B 401-67

ORDER No. 547

In the Matter of

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

This matter having been opened to the Court upon a petition of R. D. Timpany, Trustee of the Property of The Central Railroad Company of New Jersey, for authority to cancel a contract dated as of July 1, 1972 between petitioner and the State of New Jersey acting by and through its Commuter Operating Agency pursuant to the terms of said contract and for authority to terminate all passenger service of the Debtor; and the hearing on the matter having commenced on December 11, 1972 and the Court having considered all of the testimony, papers, briefs and arguments submitted with respect to same and having rendered an oral opinion at the conclusion of said hearing; and good cause appearing therefor,

Appendix A

It Is, on this 20th day of December, 1972,

Ordered that R. D. Timpany, Trustee of the Property of The Central Railroad Company of New Jersey, is hereby authorized to cancel the aforesaid contract subject to the provisions of Paragraph Fifth of the same agreement and that said cancellation shall be effective as of 11:59 on January 21, 1973; and it is

Further Ordered that R. D. Timpany, Trustee of the Property of The Central Railroad Company of New Jersey, is hereby directed to terminate all passenger service of the Debtor as of 11:59 P. M. on January 21, 1973 unless prior thereto the parties have agreed to a mutually satisfactory arrangement for the continuation of such service.

Anthony T. Augelli
S.J.U.S.D.C.

Appendix A

Oral Opinion of the Honorable Anthony T. Augelli, *U.S.D.J.*, of December 18, 1972 re Petition of Trustee to Cancel Contract and Discontinue Passenger Operations

IN THE

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW JERSEY

IN THE MATTER OF

CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

No. B 401-67

Newark, New Jersey

December 18, 1972

The Court: Gentlemen, I am prepared to render my decision in this matter. It might be a bit rambling, because it was put together in a hurry. But, nevertheless, the conclusions I have reached, I think, are sound. If they are not sound, then, of course, there is a higher authority which may test them.

In a petition filed with this Court on November 22, Mr. Timpany, trustee of the property of the Central Railroad Company of New Jersey, the debtor in these proceedings, has asked the Court to enter an order authorizing him—and I quote—"to terminate the current subsidy contract

with the State of New Jersey as of December 31, 1972, and at that time to terminate all passenger service of the debtor as of 11:59 p.m. on that date, unless, prior thereto, the State of New Jersey and your petition" —referring, of course, to Mr. Timpany—"enter into a full cost of service passenger subsidy contract."

Hearings on this petition terminated on Friday, December 15, and over the intervening weekend I have carefully reviewed my notes in this matter and have also examined the several exhibits that have been marked in evidence.

Following the weekend labors I came to a tentative conclusion as to what would be an appropriate decision in this case. The arguments of counsel, so ably made here this morning, have not resulted in any change of the tentative decision I reached over the weekend.

During the week of December 4th, as you gentlemen know, I heard testimony on the petition filed by the Manufacturers Hanover Trust Company, the indenture trustee of the debtor's mortgage bonds, which sought a termination of all operations of the debtor on some future date to be fixed by the Court.

For the reasons orally stated by me at the conclusion of that hearing, the relief requested by the indenture trustee was denied.

We now come to the present proceedings, in which the debtor's trustee, Mr. Timpany, asks for authority to suspend not all the operations of the CNJ, as had been requested by the indenture trustee, but only those operations relating to the carriage of passengers, because of the tremendous losses incurred by the debtor's estate in connection with that particular operation.

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For a number of years now the passenger operations of the CNJ have been subsidized by the State of New Jersey. The present passenger subsidy contract, dated as of July 1, 1972, entered into between the State, acting through the Commuter Operating Agency, and Mr. Timpany, as the trustee of the debtor's property, will expire on June 30, 1973. The contract contains a clause, Paragraph 17, which reserves to each party the right to cancel the agreement at the end of any calendar month upon thirty days' notice to the other party.

However, that same clause provides that if any advance payments have been made to the railroad, under another designated clause of the contract, Paragraph Fifth, then the railroad's cancellation shall not become effective until the contracted service rendered at the monthly installment rate shown in Paragraph Fifth corresponds with the payments made.

Incidentally, Mr. Timpany testified that the advance payments made by the State would obligate the CNJ to continue passenger operations to January 17, 1973. It is noted that this is beyond the requested cutoff date of December 31, 1972, stated in Mr. Timpany's petition.

On the same subject, Nelson Slater, the Assistant Commissioner for Public Transportation of the State of New Jersey, in an affidavit filed in opposition to the relief sought by Mr. Timpany, stated that the advance payments made by the State under the current subsidy contract require CNJ to continue to provide passenger service until the end of January 1973.

The annual passenger subsidy payments made by the State to CNJ are determined on an avoidable cost basis. As I understand it, avoidable loss is a measure or figure

that a company would have if it did not render a particular service. We heard more definitions of avoidable loss than were necessary during the course of this hearing and the many factors that should be considered in connection with a determination made pursuant to that formula.

The avoidable loss figure in the present contract ending June 30, 1973, according to Slater's affidavit is $5,115,101, of which $2,682,159.83 has already been paid by the State to the CNJ. Included in this $2,000,000 figure are the monthly advances I have previously mentioned, which would obligate CNJ to continue passenger service into the month of January 1973.

It is the position of the debtor's trustee, Mr. Timpany, that the present level of subsidy payments is woefully inadequate to compensate the debtor for the passenger services rendered. One reason for this is the fact that figures for a current year are based on operations for the previous year. Thus, the present subsidy contract for the fiscal year ending on June 30, 1973, sets forth figures that are based on the debtor's experience for the calendar year of 1971.

Another, and more important, reason is the fact that the amount of the subsidy made available by the State is determined on an avoidable loss basis rather than on a fully compensatory basis.

Mr. Timpany testified concerning the efforts he made to induce the State to increase the subsidy payments and to enter into a contract under which the debtor would fully recover the cost of providing adequate passenger service to the public, and also earn a return on its investment in the property used for such purpose. All of these efforts, according to Mr. Timpany, have proved fruitless.

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The record here, in my opinion, fully supports Mr. Timpany's position that continued passenger operations under present contract arrangements will result in a loss to the debtor of approximately $500,000 a month in excess of the State subsidy. The CNJ carries approximately 25,000 riders a day during the work week; or, stated differently, this would be 12,500 commuters using the trains twice daily.

The Court, of course, is cognizant of the fact that the carriage of passengers is an unprofitable railroad operation. Mr. Timpany testified that if the CNJ could be relieved of its passenger-carrying obligation and operate solely as a freight carrier, CNJ, as is shown on Exhibit T-6, could show an annual income of $828,000 after allowing for all fixed charges.

On the other hand, as shown on Exhibit T-7, if the CNJ continues to operate as a freight and passenger carrier, that operation, or combined operation, on the basis of the figures as shown on that exhibit, would result in an annual loss of $1,944,000.

Thus, on the basis of these exhibits, there is forecast for 1973 an uncompensated avoidable loss of some $2,772,000.

It is clear to me that unless some way is found to fully compensate the debtor for its passenger operations that such operations of necessity must cease. Otherwise we will run into an erosion of assets that will result in an unconstitutional taking of the debtor's property. There has been a deficit in CNJ's net income for a number of years. The figures are sizeable. All have been read into the record and the Court can, and does, take judicial notice of those figures.

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In sum, the position of the debtor is that the estimated full cost of its passenger operations is about $\$1/2$ million dollars a month more than the State subsidy payments under the existing contract.

Now, the State's position in this matter is set forth in the affidavits, filed in opposition to the Timpany verified petition, by Mr. Kohl, the New Jersey Commissioner of Transportation, and Mr. Slater, the Assistant Commissioner of Transportation. In addition to these affidavits, the State has also produced testimony of Mr. Downing, a member of the consultant firm retained by the State to help determine the amount of subsidy payments to be made to the CNJ.

This witness, Mr. Downing, disputed the debtor's need for additional funds to continue passenger operations in the amount requested. Some of his criticism was leveled at the basis used by CNJ in arriving at the figures used in T-5, which is the form of fully compensatory contract that was submitted by Mr. Timpany to the State.

Mr. Downing also took issue with the figures shown on T-8. He said that that exhibit was replete with errors.

But his testimony as a whole does not dispute the loss figures. Indeed, Mr. Downing admitted that the 1972 figures would be higher, but that a determination of such higher figures could not be made until after the end of the year 1972.

The affidavits of Commissioner Kohl and Mr. Slater stress the fact that no funds are available to meet the CNJ request. The proposed new contract submitted to the State by Mr. Timpany is criticized. The demands of the CNJ are characterized by Mr. Slater as being excessive, and also that the service rendered is inadequate. The Slater affidavit also recites that, based upon advice

furnished to the State by Mr. Downing's firm, the subsidy figure for the fiscal year ending June 30, 1973, should not exceed the sum of $5,115,101. That is the figure that is set forth in Mr. Slater's affidavit.

During the recess, gentlemen, I have again gone over my notes and examined the exhibits. There is no question in my mind that the losses attributable to passenger service are eating into the very heart of this unfortunate carrier. The State wants CNJ to continue passenger operations through June 30, 1973. CNJ answers that it cannot do so unless it is fully compensated for performing that service.

CNJ asks this Court to terminate the present subsidy contract as of December 31, 1972, and at that time to terminate all passenger services of the debtor as of 11:59 p.m. on that date, unless, prior thereto, suitable arrangements can be made with the State to continue the carriage of passengers.

However, the two advance payments made by the State to the CNJ, in my opinion, obligate the CNJ to continue passenger services beyond December 31, 1972. Mr. Timpany testified, on the basis of the moneys advanced, that passenger service can continue until January 17, 1973.

Upon a consideration of many factors involved in this case, I have decided—somewhat reluctantly—to authorize Mr. Timpany to terminate his subsidy contract in accordance with Paragraph 17 thereof, and subject to the provisions of paragraph fifth of the same agreement. The termination of the contract will be effective not as requested by Mr. Timpany, but will be effective as of Sunday, January 21. And the trustee is directed to terminate all passenger service of the debtor as of 11:59 p.m. on said date of January 21, 1973.

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Mr. Bossolt has stated that there should be no difficulty —although I am not holding him to it—there should be no difficulty in having the CNJ paid for the services rendered between the dates of January 17 and January 21, 1973.

Now, the present subsidy contract, in addition to the paragraphs I have just mentioned, also contains a Paragraph 16. And that reads as follows, "The parties agree to cooperate in a study of possible revisions to this agreement and to incorporate such changes if it is found that such action is feasible and in the public interest."

Perhaps the parties should pay a little attention to the spirit behind that particular paragraph. Perhaps between now and the time the cancellation becomes effective the parties can get together to the end that perhaps this particular carrier can continue to operate both freight and passenger service in the State of New Jersey.

I have not cited cases. But I do think that I have the necessary authority, and the necessary jurisdiction, and the necessary power to grant the relief as I have granted it. Two principal cases, of course, are the ones that might be looked at—and I think that counsel are familiar with both of them—and one is the Brooks-Scanlon case, reported in 251 U.S. 396, and the other is the Eastern Texas case, reported in 264 U.S. 79. And, of course, there are other cases, too. And I also have in mind my Order number 445, which was upheld on appeal, pursuant to which I autho ized the debtor to discontinue unprofitable operations in the Commonwealth of Pennsylvania.

Gentlemen, there you have it. And you will submit, Mr. Weiss, an appropriate order carrying out the Court's determination.

Appendix A

Order No. 549 Denying Petition of Manufacturers Hanover Trust Company to Suspend Debtor's Operations

(Filed December 20, 1972)

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW JERSEY

In the Proceedings for the Reorganization of a Railroad

No. B 401-67

ORDER No. 549

In the Matter of

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

This matter having originally been opened to the Court upon a petition of Manufacturers Hanover Trust Company and order to show cause why all railroad operations of the Debtor should not be suspended on a date certain; and the matter having been adjourned by Order No. 506; and the hearing date on said petition and order to show cause having been fixed by Order No. 531; and the hearing on said matter having commenced on December 4, 1972; and the Court having considered all of the testimony, briefs and arguments submitted with respect to same and having rendered an oral opinion at the conclusion of said hearing; and good cause appearing therefor;

IT IS on this 20th day of December, 1972,

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ORDERED that the petition of Manufacturers Hanover Trust Company for the suspension of the Debtor's operations is denied and the order to show cause with respect thereto discharged without prejudice to the rights of petitioner to renew its application.

ANTHONY T. AUGELLI
S.J.U.S.D.C.

Appendix A

Oral Opinion of the Honorable Anthony T. Augelli, *U.S.D.J.*, of December 8, 1972 re Bondholders' Petition for Suspension of All Railroad Operations

IN THE

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEW JERSEY

IN THE MATTER OF

CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

No. B 401-67

Newark, New Jersey

December 8, 1972

The Court: Because of the public interest in this matter and the newspaper publicity that the hearing here has received, I have decided to make known my decision today.

Number 1, I have decided preliminarily that I do have the power to grant the relief.

Number 2, the bondholders will not be precluded by the doctrine of collateral estoppel.

And I might say I am familiar with the mortgage indenture. I am familiar with the Wyer, Dick valuation study. And, of course, for five years I have lived with this case—a little over five years. I know all of the operating losses and the difficulties that the railroad has encountered in its operations. I can appreciate, also, that it does need more

money if it is going to operate its passenger services at less than the tremendous losses being incurred today on the basis of an avoidable loss contract.

But I am afraid that on the basis of the present record I cannot give the bondholders the relief they seek, namely, that I shut down total operations of the Central Railroad Company of New Jersey on some date to be fixed by me.

I think that is a drastic step and one that should only be taken on a sufficient record.

I have in mind that on December 11 I will be confronted with another application, and this by the trustee. In his petition he asks for an Order authorizing him to terminate the current subsidy contract with the State of New Jersey as of December 31, 1972, and at that time to terminate all passenger service of the debtor as of 11:59 p.m. on that date, unless prior thereto the State of New Jersey and the trustee—Mr. Timpany—enter into a full cost of service passenger subsidy agreement.

What I will do with that one, of course, I don't know. And my dismissal of Mr. Ward's application at this time is without prejudice to his coming into that proceeding, if he wishes to.

I do think that we have shown some improvement. We have got a long way to go. But I don't think that as of yet the assets of this estate have so eroded that the constitutional line has been passed, where there has been a taking of the bondholders' property in violation of the Fifth Amendment. I don't think we have reached that point yet.

That is not to indicate that we might not reach it. But I am deciding the application that is pending before me on the basis of the present record.

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We cannot lose sight of the fact that some progress has been made and that conditions subsequent to March of 1971 have helped rather than hindered the estate, and consequently those who hold security interests in the estate.

In Judge Anderson's opinion, the one reported in 281 F. Supp. 65, there is laid down this rule, or this statement made by the ICC, and approved by the Supreme Court in its New Haven inclusion opinion, approving the Penn Central merger. And that statement reads as follows—it is on page 67:

> "It is a fundamental aspect of our free enterprise economy that private persons assume the risks attached to their investments and the New Haven creditors can expect no less because the New Haven's properties are devoted to a public use."

Then Judge Anderson goes on to quote Justice Fortas' opinion. Justice Fortas was then speaking for the majority. And he said that while the rights of the bondholders are entitled to respect, they do not command Procrustean measures.

I used the word "drastic" instead of "Procrustean."

I think we have got to be realistic. And I, for one, am not going to permit this railroad to continue operating to the detriment of anybody—bondholders or anyone else. I do think the public interest must be served. And I think it will be served by a continuation of service, at least for the time being.

We have had some changes here, and they are all changes that I think are very beneficial, and will be of benefit to the estate generally. And I have reference to a few of them that were mentioned here.

One is the Liberty Park deal, where there is a lease of 17 acres in that area. There was also a $10 million figure thrown around—negotiations on the sale of the property. Whether that will materialize—apparently it is not enough, because Mr. Wachenfeld has some litigation concerning that particular property.

We have the layoff of the employees. An unfortunate thing, but nevertheless necessary. Sometimes drastic action must be taken. I have always said that I wished that there was more cooperation between the labor force and management in this particular railroad. I always thought that work rules should have been changed long, long ago. But we finally did. We finally reached the situation now where we have made some drastic changes in the work rules that are going to be very beneficial.

And you have got the decrease in personnel. That is going to be very helpful.

There has been a profit increase on the use of their cars from $103—my notes show—to $130. These figures are not exact.

Then we have the bad order cars that were leased to Rock Island on a per diem basis. That is bringing in income.

Of course, we have the subsidy contract with the State of New Jersey, which pours in—whatever it does—not enough, but still—I think there were two drawdowns. There is still a balance of some $5 million, is there, due by June of 1973?

Mr. Ward: Two million, your Honor.

The Court: Two million. There have been advances, that's why.

We know we have the DOT behind us, to a certain extent. And I might say right now that $900,000 should be made available, Mr. Sharfman, right away quick.

Yes?

Mr. Sharfman: It will be, your Honor.

The Court: Then we have the Elizabeth lease, the Port leases; the possible joint use, or use in common of a bridge, and the sale of a bridge for four million something; the trailer container facility.

And I could go on with a few others. But you all heard what they are. But they are all indications, they are all activity, they all indicate that improvement is being made, that the condition of the railroad is not too bad, insofar as the bondholders' security is concerned.

It may be that there will be changes. And I don't doubt that there will. And I think we are going to reach the point very soon—not too far away—where this Court is going to make a determination that either this railroad keeps on rolling along or we are going to shut the whole kit and kaboodle down. All I am deciding today is that on the basis of the present record I cannot grant the relief sought by the bondholders. And that denial is made without prejudice. It may be that the bondholders will want to give a look at what happens on December 11 and then govern themselves accordingly.

You will now submit an appropriate Order, Mr. Weiss. And that is it.

Mr. Weiss: Thank you, your Honor.

Appendix A

Judgment Dated March 7, 1973

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 73-1006 and 73-1027

In the Matter of

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

STATE OF NEW JERSEY,

Appellant in No. 73-1006

COMMONWEALTH OF PENNSYLVANIA and
PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Appellants in No. 73-1027

(D. C. No. B-401-67 in Bankruptcy)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT

FOR THE ..... DISTRICT OF NEW JERSEY

Present:

MARIS and ALDISERT, *Circuit Judges* and
GORBEY, *District Judge.*

This cause came on to be heard on the record from the United States District Court for the ..... District of New Jersey and was argued by counsel.

Appendix A

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed December 20, 1972, be, and the same is hereby affirmed, with costs taxed against appellants.

ATTEST:

THOMAS P. QUINN
Clerk

March 7, 1973

Appendix A

Per Curiam Opinion of Court of Appeals for the Third Circuit

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

In the Matter of

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

No. 73-1006
Appeal of State of New Jersey

No. 73-1027
Appeal of Commonwealth of Pennsylvania and Pennsylvania Public Utility Commission

---

(D. C. No. B 401-67 Bankruptcy)

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Argued March 1, 1973

Before:

MARIS and ALDISERT, *Circuit Judges*, and GORBEY, *District Judge*.

STEPHEN SKILLMAN,
Assistant Attorney General,
Trenton, N. J.
for Appellant in No. 73-1006

Appendix A

GORDON P. MACDOUGALL,
Special Assistant Attorney General,
Washington, D. C.
For Appellants in No. 73-1027

STANLEY WEISS,
Newark, N. J.
For Trustee of Central Railroad Company of New Jersey

ROGER C. WARD,
Newark, N. J.
For Manufacturers Hanover Trust Company, Indenture Trustee

JACOB I. GOODSTEIN,
New York, N. Y.
For 3¼% Mortgage Bondholders Protective Committee

Appendix A

OPINION OF THE COURT

(Filed March 7, 1973)

PER CURIAM:

These appeals seek the reversal of the order entered by the district court in this railroad reorganization proceeding authorizing the debtor railroad to abandon all passenger service. The error asserted is that the railroad should first have applied to the appropriate state regulatory agency or to the Interstate Commerce Commission for permission to abandon the service in question. We have carefully considered this contention as presented by the appellants in their briefs and oral argument but find it unpersuasive in the light of the facts of the case. See *In the Matter of the Central Railroad Company of New Jersey, Debtor*, 3 Cir. 1972, 455 F.2d 989.

The order (No. 547) of the district court will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

Appendix A

Order dated March 26, 1973 Vacating Judgment and Ordering the Listing of Case for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 73-1006

In the Matter of

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor

STATE OF NEW JERSEY,

Appellant

Present:

SEITZ, *Chief Judge,*

MARIS, VAN DUSEN, ALDISERT, ADAMS, GIBBONS and ROSENN,

Circuit Judges.

Upon consideration of appellant's petition for rehearing in the above-entitled case,

It is ORDERED that appellant's petition for rehearing in the above-entitled case be, and hereby is granted;

It is Further ORDERED that the judgment of this Court entered March 7, 1973, be, and hereby is vacated; and

It is Further ORDERED that the Clerk of this Court list this case for rehearing before the Court en banc at a time set for the convenience of the Court.

By the Court,

ARLIN M. ADAMS
Circuit Judge

Dated: 3/26/73

Appendix A

Order dated March 26, 1973 Vacating Judgment and Ordering the Listing of Case for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 73-1027

In the Matter of

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor

COMMONWEALTH OF PENNSYLVANIA and
PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Appellants

Present:

SEITZ, *Chief Judge*,

MARIS, VAN DUSEN, ALDISERT, ADAMS, GIBBONS and ROSENN,

Circuit Judges.

Upon consideration of appellants' petition for rehearing in the above-entitled case,

It is ORDERED that appellants' petition for rehearing in the above-entitled case be, and hereby is granted;

It is Further ORDERED that the judgment of this Court entered March 7, 1973, be, and hereby is vacated; and

It is Further ORDERED that the Clerk of this Court list this case for rehearing before the Court en banc at a time set for the convenience of the Court.

ARLIN M. ADAMS
Circuit Judge

Dated: 3/26/73

Appendix A

Judgment on Rehearing

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 73-1006 and 73-1027

In the Matter of:

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

STATE OF NEW JERSEY,

Appellant in No. 73-1006

COMMONWEALTH OF PENNSYLVANIA and
PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Appellants in No. 73-1027

(D. C. No. B-401-67 In Bankruptcy)

ON APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE ..... DISTRICT OF NEW JERSEY

Present:

SEITZ, *Chief Judge* and VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN, HUNTER and WEIS, *Circuit Judges.*

This cause came on to be heard on the record from the United States District Court for the ..... District of New Jersey and was reargued by counsel.

Appendix A

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed December 20, 1972, be, and the same is hereby reversed and the cause is remanded for proceedings consistent with the opinion of this Court. Costs taxed against the appellees.

ATTEST:

M. ELIZABETH FERGUSON
Chief Deputy Clerk

August 27, 1973

Appendix A

Opinions of Court of Appeals for the Third Circuit Upon Rehearing in Banc

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

In the Matter of

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor.

No. 73-1006
Appeal of State of New Jersey

No. 73-1027
Appeal of Commonwealth of Pennsylvania
and Pennsylvania Public Utility Commission

(D.C. No. B401-67 Bankruptcy)

APPEALS FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

Argued March 1, 1973

Before:

MARIS and ALDISERT, *Circuit Judges*, and
GORBEY, *District Judge*.

Reargued May 23, 1973

Before:

SEITZ, *Chief Judge*, VAN DUSEN, ALDISERT, ADAMS,
GIBBONS, ROSENN, HUNTER and WEIS, *Circuit Judges*.

STEPHEN SKILLMAN
Assistant Attorney General,
Trenton, N.J.
For Appellant in No. 73-1006

Appendix A

GORDON P. MACDOUGALL,
Special Asst. Attorney General,
Washington, D.C.
Appellants in No. 73-1027

STANLEY WEISS,
Newark, New Jersey
For Trustee of Central Railroad
Company of New Jersey

ROGER C. WARD,
Newark, New Jersey
For Manufacturers Hanover Trust
Trust Company, Indenture Trustee

JACOB I. GOODSTEIN,
New York, New York
For 3¼% Mortgage Bondholders
Protective Committee

Appendix A

OPINION OF THE COURT

(Filed August 27, 1973)

ADAMS, *Circuit Judge:*

May a district judge presiding over a railroad reorganization, pursuant to Section 77 of the Bankruptcy Act,[1] permit the Trustees of the railroad to discontinue a loss-producing service or must he withhold his authorization until the Trustees have applied to federal or state regulatory agencies for permission to terminate the service?

The State of New Jersey answers that permitting the discontinuance before administrative review would thwart any attempt to create a viable rail system essential to the economic life of the region. The Trustees of the Central R. Co. of New Jersey, by way of rejoinder, assert that denying the request for discontinuance could result in an unconstitutional taking of property. Resolution of this appeal requires this Court to address these contentions.

I.

The Central Railroad of New Jersey (Central) is one of the many railroads[2] in the Northeast that is presently undergoing reorganization pursuant to section 77 of the Bankruptcy Act. The Central's lines, prior to entry into reorganization, extended from the Newark-Jersey City area in Northeastern New Jersey west to the northeast corner

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[1] 11 U.S.C. § 205.

[2] Other railroads which have begun court-supervised reorganizations include the Penn Central, Lehigh & Hudson River, Reading, Lehigh Valley, Erie Lackawanna, New Hope & Ivyland, New Haven and the Boston & Maine.

of Pennsylvania[3] (the "hard coal region") and south to Southern New Jersey, ending near the Delaware Bay.

The majority of the customers served by the Central are located in the Northern New Jersey metropolitan area. In that region, the Central provides shipping services for industry and, more significantly for this appeal, carries approximately 25,000-30,000 riders a day.[4] The vast majority of these riders are commuters who use the train to travel from western and southern suburbs into Newark or Jersey City. Many of these commuters continue to New York, using other public transportation facilities.

The State of New Jersey has for a number of years provided subsidies to the several railroads that transport commuters in New Jersey. Since the entry of the Central into reorganization in March, 1967, that railroad has received annual subsidies from the state ranging from a high of $5,100,000 in 1972 to a low of $4,400,000 in 1970. The granting of the subsidy has been made pursuant to contracts entered into between the railroad and the state acting through its Commuter Operating Agency. Many of the terms of the contracts are prescribed by statute. In July of 1972, the railroad and the state contracted for the Central to continue to furnish passenger service through June 30, 1973. The railroad was obligated to run trains according to an agreed upon schedule and compensation was to be paid by the state on the basis of the railroad's "avoidable

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[3] The Pennsylvania service of the Central was terminated pursuant to Order No. 445 of the Reorganization Court, issued December 20, 1971. The Order was affirmed by this Court, In the Matter of Central R. Co. of New Jersey, 455 F.2d 989 (3d Cir. 1972).

[4] A rider is a passenger on a one-way trip. A commuter who rides the train to work in the morning and from work in the evening would be counted as two riders.

loss" for the preceding year.[5] Article Seventeenth of the contract provided:

> "Each party reserves the right to cancel this agreement at the end of any calendar month upon 30 day's notice to the other party."[6]

Alleging that the subsidy paid by the state was inadequate to compensate the railroad, the Trustees petitioned the reorganization court for permission to exercise their right of cancellation under the contract and to terminate all their passenger services in New Jersey.

The district court, in an order dated December 20, 1972,[7] based on an oral opinion delivered earlier,[8] granted the Trustees' petition, and ordered termination of all passenger service as of January 21, 1973. The district court's order was appealed to this Court and a panel of the Court, relying on a brief per curiam opinion permitting suspension of the Central's Pennsylvania operations,[9] affirmed the decision of the district court.

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[5] The "avoidable loss" figure is computed by determining whether a particular cost would be avoided if passenger service were discontinued.

Under a "full cost" compensation program, the railroad is reimbursed for all expenses involved in operating the passenger service, not just those which are attributable exclusively to that service.

Thus, under the full cost system the railroad is compensated pro rata for management expenses, depreciation and debt service. These items, if not directly related to the provision of passenger service, would be uncompensated under the "avoidable loss" program.

By statute, New Jersey has changed its compensation within the past year from "avoidable loss" to "full cost."

[6] Appendix at 25a.

[7] Order No. 547, Appendix at 435a.

[8] Appendix at 423a.

[9] In the Matter of the Central R. Co. of New Jersey, 455 F.2d 989 (3d Cir. 1972). (The panel consisted of Circuit Judges Maris and Aldisert and District Judge Gorbey.)

Appendix A

The State of New Jersey and the Commonwealth of Pennsylvania[10] filed petitions for rehearing before the Court En Banc. The petitions were granted and argument before the Court En Banc was had on May 23, 1973.[10a] The termination of passenger service has been stayed pending resolution of this appeal.[11] Such resolution is now incumbent upon us.

II

The Trustees first contend that this Court must affirm the district court because the Court is bound by the doctrines of "law of the case" and *stare decisis* to follow its earlier decision permitting the suspension of service in Pennsylvania.[12] This contention is without merit, for it has long been the rule in this Circuit that decisions made in similar cases[13] by panels of this Circuit are binding on other panels but are not controlling on the Court En Banc. Indeed, it is only through the Court En Banc that prece-

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[10] Pennsylvania's interest in the termination arises from the existence of four trains a day between Philadelphia and Newark, which are operated jointly by the Reading Railroad and the Central. Pennsylvania's argument parallels New Jersey's, and future reference will be to New Jersey only.

[10a] Judge Maris did not sit with the Court En Banc because of a temporary illness. Judge Gorbey did not sit since district judges are not authorized to sit on en banc rehearings in the Court of Appeals.

[11] *See* N.Y. Times, July 1, 1973, at 25, col. 8.

[12] In the Matter of Central R. Co. of New Jersey, 455 F.2d 989 (3d Cir. 1972).

[13] The similarity of this case with the cause involving terminations in Pennsylvania is not sufficiently great to permit the invocation of the doctrine of "preclusion" against New Jersey. Scarano v. Central R. Co. of New Jersey, 203 F.2d 510 (3d Cir. 1953), indicates the greater congruence necessary for the doctrine to be operative.

dents established by earlier panel decisions may be re-examined.[14]

In addition, the Pennsylvania case is distinguishable from this appeal. The former decision authorized suspension of certain passenger services pending ICC action on applications for abandonment of such service, which action was arguably unduly delayed. In the present case, however, the Trustees have not filed applications with either the ICC or state regulatory authorities.

A review of the earlier decision must begin with an examination of the railroad reorganization statute and proceed to an explication of the relationship between administrative agencies and a district court supervising a railroad reorganization under that statute.

III.

The decision to permit termination was made by the district court in December, 1972. At that time, the Trustees had not sought approval for the termination of passenger service in any forum other than the district court. No action had been commenced before the New Jersey regulatory agencies; no abandonment proceedings had been initiated before the Interstate Commerce Commission.[15]

A termination of passenger service is an action that may not fall squarely within the ambit of statutes which control abandonments of railroad lines or portions

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[14] *See e.g.*, United States ex rel. *Reed v. Anderson*, 461 F.2d 739 (3d Cir. 1972), *overruling*, United States v. Zeiler, 427 F.2d 1305 (3d Cir. 1970).

[15] A reorganization plan had been filed by the Trustees with the ICC in August, 1971. But such plan, which is still pending before the ICC, included continued passenger service, not termination of such service. Brief of Appellants at 2.

thereof.[16] However, whether the termination is or is not denominated an abandonment, prior administrative approval appears mandated before a district court overseeing a reorganization may permit the discontinuance of an important component of a region's rail service.[16a]

Section 77(o) provides that the district court may permit abandonment of "lines or portions of lines of railroad." It states, in pertinent part:

> "(o) The trustee or trustees, from time to time, shall determine what lines or portions of lines of railroad and what other property of the debtor, if any, should be abandoned or sold during the pendency of the proceedings in the interest of the debtor's estate and of ultimate reorganization but without unduly or adversely affecting the public interest, and shall present to the judge petitions, in which other parties in interest may join, for authority to abandon or to sell any such property; and upon order of the judge made after a hearing pursuant to such reasonable notice by publication or otherwise as the judge may direct to parties in interest, authorizing any such abandonment or sale, but only with the approval and authorization of the Commission when requested by chapter 1 of Title 49, as amended February 28, 1920, or as it may be hereafter amended. . . ." [17]

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[16] *See e.g.*, Section 77(o), 11 U.S.C. § 205(o). *Compare* Smith v. Hoboken R. Co., 328 U.S. 123 (1946), *with* Board of Public Utility Com'rs. of New Jersey v. United States, 158 F. Supp. 98 (D. N.J. 1958), *prob juris noted*, 357 U.S. 917 (1958), dismissed as moot 359 U.S. 982 (1958).

[16a] For the purposes of the present appeal, this Court has assumed that the district court would have the power to permit termination of certain rail services if such termination had been approved by the appropriate administrative agency.

[17] 11 U.S.C. § 205(o).

Appendix A

As section 77(o) makes clear, if the railroad is subject to the jurisdiction of the ICC, no abandonment may take place without the approval of that agency.[18]

If the termination of passenger service is not denominated an abandonment, or if the Central's service is not subject to the purview of the ICC,[19] the requirement of ICC approval mandated by section 77(o) would appear not to apply. Nonetheless, the district court may not be free to permit termination without prior administrative approval.

New Jersey has developed its own administrative agencies that regulate the conduct of certain railroads within the state. Approval of the appropriate agency is required under New Jersey law before any service may be discontinued.[20] If the approval of the state agency is withheld or unduly delayed, under a special provision recourse may be had to the ICC.[21]

The Supreme Court has explicitly stated that compliance with a state's regulatory program is required of railroads undergoing reorganization.

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[18] This Court has recently discussed at some length, the role of subsection (o) in the general schema of section 77. *See* In the Matter of Penn Central Transportation Co. (Sale of Park Avenue Properties), Nos. 72-2116—72-2126 (3d Cir. filed June 14, 1973). Whether the import of that case, limiting extensive sales dispositions made pursuant to a reorganization plan, would affect abandonment made with ICC approval but not following a plan of reorganization is a question not involved in the resolution of this case.

[19] It may be contended that since the operations are intrastate, they are not subject to ICC control.

[20] If, as is true here, the termination is of passenger service provided under a contract involving public funds, approval of the Commuter Operating Agency would be necessary. N.J.S.A. 27:1A-24. Were public funds not involved, application must be made to the Board of Public Utility Commissioners. N.J.S.A. 48:2-13.

[21] 49 U.S.C. § 13a(2).

Appendix A

Palmer v. *Massachusetts*[22] involved an attempt by the Trustees of the New Haven Railroad to terminate passenger service to eighty-eight stations in the Boston region. To effectuate such a termination, the Trustees, as required by state law, began proceedings before the Massachusetts Department of Public Utilities. While the state hearings were being conducted, the Trustees applied to the district judge supervising the reorganization for permission to carry out the same terminations. The district court, "ruled that § 77 gave him the responsibility of disposing of the petition on its merits and, having taken evidence, gave the very relief for which the Trustees had applied to the Department and which was still in process of orderly consideration."[23] The U.S. Court of Appeals for the Second Circuit reversed,[24] and the Supreme Court affirmed that reversal.

In holding that the district court supervising the reorganization did not have the power to permit terminations in derogation of state regulatory procedures,[25] the Supreme Court, speaking through Justice Frankfurter, strongly emphasized the importance of preserving state control in the first instance:

> "In view of the judicial history of railroad receiverships and the extent to which § 77 made judicial action dependent on approval by the Interstate Commerce Commission, it would violate the traditional respect of Congress for local interests and for the administrative process to imply power in a single judge

[22] 308 U.S. 79 (1939).

[23] Palmer v. Massachusetts, 308 U.S. 79, 83 (1939).

[24] Converse v. Massachusetts, 101 F.2d 48 (2d Cir. 1939).

[25] Terminations made pursuant to a plan of reorganization do not need state approval. Section 77(f), 11 U.S.C. 205(f).

to disregard state law over local activities of a carrier the governance of which Congress has withheld even from the Interstate Commerce Commission, except as part of a complete plan of reorganization for an insolvent road." [26]

It may be argued that the crisis now confronting the eastern railroads and the great changes that have come about in the economy generally, and to the railroad industry in particular, require a different result from that reached in *Palmer*. However, the blunt fact is that *Palmer* has not been undercut by subsequent decisions of the Supreme Court, nor has its vitality been called into question.

One aspect of *Palmer* v. *Massachusetts* has, in fact, been strongly reiterated in the *New Haven Inclusion Cases*.[27] There, the Supreme Court emphasized the important role of a regulatory agency, the ICC,[28] in the administration and resurrection of railroads in reorganization.[29]

In the present case, the district court approved the termination of the passenger service without having required that the proposal first be submitted to an appropriate regulatory agency. Unless this case is not controlled by section 77(o) or *Palmer* v. *Massachusetts*, it would appear that the district court's action was not proper.

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[26] 308 U.S. at 88 (citation omitted).

[27] 399 U.S. 392 (1970).

[28] The ICC can play a role in termination proceedings committed in the first instance to state regulatory agencies. *See* 49 U.S.C. § 13a(2). That section was added to the statute in 1958, to permit ICC action in the event of adverse state agency actions. Thus, there was no role for the ICC at the time of Palmer v. Massachusetts.

[29] New Haven Inclusion Cases, 399 U.S. 392, 431 (1970).

IV.

The Trustees contend that termination must be permitted at this time, without agency consideration. Such termination, they assert, is necessary to stop the financial drain on the railroad, which has risen to such a magnitude so as to be an unconstitutional taking of property.

Underlying the taking argument is the basic principle that an owner of property retains the right ultimately to withdraw that property from a losing venture.[30] Indeed, such a right appears to be a fundament of the taking provision.[31] Operation of the passenger services, if not more adequately compensated, would, at some point, so substantially reduce the assets remaining in the railroad that the continuation would constitute a taking.

The Trustees might contend that a requirement that they seek relief now from the appropriate agency would result in further delay in termination and that any delay would exacerbate an already critical financial situation. They might further argue that the resort to New Jersey agencies would most likely provide only frustration, and therefore would be an empty formality.

However, the fact remains that the Trustees have not sought relief from the appropriate agency. There having

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[30] *See* Note, *Takings and the Public Interest in Railroad Reorganization*, 82 Yale L.J. 1004 (1973). The Note describes the practice followed in the New Haven Railroad's reorganization wherein the continued operation of the railroad reduced the value of the physical plant of the road and thus eroded the creditors' assets. The Note states that this practice was approved by the Supreme Court and argues that by so approving, the Court has substantially altered the meaning of the taking clause.

[31] *See* Brooks-Scanlon Co. v. Railroad Comm., 251 U.S. 396 (1920); Railroad Comm. of Texas v. Eastern Texas R. Co., 264 U.S. 79 (1924).

been no application made, there can be no showing that delay[32] or frustration[33] would be the inevitable result.

The cases of *Brooks-Scanlon Co.* v. *Railroad Comm.*[34] and *Railroad Comm. of Texas* v. *Eastern Texas R. Co.*[35] make clear that a railroad may not be required to remain in business in the face of confiscatory losses. Both of these cases, however, dealt with attempts by each railroad to leave the railroad business entirely. In the present case, the Trustees do not seek to abandon all their railroad operations. Rather they ask to terminate only the passenger service. In contradistinction to the situation now before us, the earlier cases involve attempts by the unprofitable venture to renounce their state-granted franchise completely. Here, the Trustees would have the district court permit them to select those aspects of their state-granted privilege they choose to accept without allowing the state to impose any further burden on the exercise of the privilege.[36]

Further, these two cases do not decide whether in seeking to terminate a service, the Trustees may, with the approval of the district court, by-pass the state and federal administrative procedures.

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[32] It may be noted that the ICC has adopted new procedures expediting the disposition of applications for abandonment of lines. *See* Commonwealth of Pennsylvania v. United States, No. C.A. 72-63 (M.D. Pa. filed June 4, 1973).

[33] Were the Trustees unsuccessful before the state agency, recourse could be had to the ICC pursuant to 49 U.S.C. § 13a(2).

[34] 251 U.S. 396 (1920).

[35] 264 U.S. 79 (1924).

[36] *See* Fort Smith Traction Co. v. Bourland, 267 U.S. 330 (1925). *But see* Norfolk & Western Ry. Co. v. West Virginia, 236 U.S. 605 (1915). Under section 77(g). 11 U.S.C. § 205(g), the Trustees could ask that the proceedings be dismissed, thus, perhaps, resulting in the railroad's ultimate withdrawal from the railroad business.

Appendix A

In *Brooks-Scanlon*, the action underlying the case was an order of the Railroad Commission of Louisiana requiring a lumber company to operate its railroad on schedules approved by the Commission. With the Commission having already acted, and having mandated continuation of the confiscatory services, the Supreme Court held that the railroad need not formally petition the Commission for permission to terminate. The Court, through Justice Holmes, stated:

> "[I]t seems unlikely that after the Commission has called the plaintiff before it on the question and against its strenuous objection has required it to go on, such an empty form cannot be required." [37]

With the position of the Commission being clear, the Supreme Court could then state,

> "Whatever may be the forms required by the local law it cannot give the Court or Commission power to do what the Constitution of the United States forbids which is what the order and the injunction attempt." [38]

In *Eastern Texas*, the railroad was attempting to abandon the intrastate service on the railroad. Interstate service had already been abandoned after such abandonment had been approved by the ICC.[39]

The Trustees here, however, have not sought any administrative review whatsoever. Thus, there can be no clear statement that the agencies would require service continued as is, that they would attempt to impose confis-

[37] 251 U.S. at 400.

[38] *Id.*

[39] 264 U.S. at 83.

catory requirements, or that they would not grant suitable relief.

Palmer v. *Massachusetts* clearly states that administrative agencies may not be disregarded.

> "Continuance of state control over these local passenger services will, it is urged, impair the bankruptcy court's power to formulate a reorganization plan for the approval of the Interstate Commerce Commission. Such embarrassments, due either to the time required for exhaustion of the orderly state procedure or to the financial losses that may be involved in the continuance of local services until duly terminated by the state, may easily be exaggerated. It is not without significance that after four years no reorganization plan for the New Haven has yet been evolved. Perhaps it is no less true that amenability to state laws will serve as incentive to the formulation of reorganization plans which, on approval by the Commission, do supplant state authority. But, in any event, against possible inconveniences due to observance of state law we must balance the feelings of local communities, the dislocation of their habits and the over-riding of expert state agencies by a single judge. . . ." [40]

Therefore, this Court holds that termination of passenger service cannot be ordered by the district court supervising the reorganization of a railroad under section 77, unless such termination has been approved by the appropriate agency.[41]

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[40] 308 U.S. at 89.

[41] This Court need not decide, at this time, whether such termination order should be granted if there appeared to the district court to be undue delay by the administrative agency.

Appendix A

V.

This Court's holding does not preclude district courts from permitting ailing railroads to terminate services. Rather, it holds only that the reorganization court require railroads seeking terminations to follow certain procedures. Adherence to such procedures is not an exercise in formalism. Rather, such adherence reflects two important concerns. First, application to the appropriate state agency preserves the balance between federal and state powers in this field. Second, administrative review assures that an agency with substantial expertise, be that agency state or federal, will provide that the appropriate amalgam of public concerns for rail transport and private rights of property is achieved.

Having reached this result, however, the Court must express its disquiet over the plight of the bondholders of this railroad, and the other railroads whose reorganizations are being conducted by courts of this Circuit. In many respects, it is their equity which is being used to sustain these railroads. Such a situation is most unfortunate. The dissenting opinion paints a most graphic and colorful picture of this serious condition. Yet, this Court may provide such bondholders and other creditors relief only within the confines of Section 77, the enactment which encompases the procedure mandated by the Congress, and the Supreme Court opinions interpreting that statute.

Were this Court not a judicial body but a legislative body, it could fashion perhaps a more equitable system for financing vitally needed yet inherently unprofitable rail services. Indeed, the time is rapidly approaching when both federal and state legislative bodies must squarely meet that responsibility. Such is not our prescribed role, how-

ever as enticing as such assignment might be. Instead, our task is to apply the statute Congress has enacted unless such statute inexorably conflicts with the Constitution. The record in this case does not demonstrate that such conflict has happened here—at least, not as yet.[42]

Therefore, the judgment of the district court will be reversed and the case remanded for proceedings consistent with this opinion.

Appendix

Statements by Trial Court Bearing on Question of "Taking"

". . . unless some way is found to fully compensate the debtor for its passenger operations that such operations of necessity must cease. Otherwise we *will* run into an erosion of assets that *will* result in an unconstitutional taking of the debtor's property." (Emphasis added)

"CNJ asks this Court to terminate the present subsidy contract as of December 31, 1972, and at that time to terminate all passenger services of the debtor as of 11:59 p.m. on that date, *unless, prior thereto,*

[42] There is set forth in the attached Appendix a series of statements by the distinguished and able trial judge who has supervised the reorganization, which illustrate that the point of a taking, in the sense of due process, has not yet been established in this proceeding so as to justify a deviation from the mandate of Section 77. The statements are contained in the district court's opinion on the Trustees' motion to cancel the passenger contract and on the petition of Manufacturers Hanover Trust Company to terminate all operations of the Central.

***suitable arrangements can be made with the State to continue the carriage of passengers.*"** (Emphasis added)

"Perhaps the parties should pay a little attention to the spirit behind that particular paragraph. Perhaps between now and the time the cancellation becomes effective the parties can get together to the end that perhaps this particular carrier can continue to operate both freight and passenger service in the State of New Jersey."

"We cannot lose sight of the fact that some progress has been made and that conditions subsequent to March of 1971 have helped rather than hindered the estate, and consequently those who hold security interests in the estate."

"We have had some changes here, and they are all changes that I think are very beneficial, and will be of benefit to the state generally. And I have reference to a few of them that were mentioned here."

"And I could go on with a few others. But you all heard what they are. But they are all indications, they are all activity, they all indicate that improvement is being made, that the condition of the railroad is not too bad, insofar as the bondholders' security is concerned."

DISSENTING OPINION

ALDISERT, *Circuit Judge,* with whom WEIS, *Circuit Judge,* joins, Dissenting.

Appendix A

I would affirm the order of the district court and reaffirm the action of the panel which first considered this appeal.[1] I would hold that the reorganization court had jurisdiction to act and that its order did not constitute an abuse of discretion.

Because my approach differs substantially from that of the majority, it becomes necessary first to outline general contours of the crisis facing our nation's passenger rail carriers today. I deem such an understanding to be essential to the solution of the problem of this case.

I.

As a legal essay the majority opinion appears sound. And it would have been acceptable if written some three decades ago when the railroads whose passenger lines run through this judicial circuit were a viable segment of private industry; at a time when the emergency federal financial subsidy legislation and the New Jersey state commuter's support legislation were not yet on the statute books. But this is 1973, and I believe that a 1973 federal court should look at this 1973 New Jersey commuter railroad problem from a 1973 perspective. This perspective includes a recognition of five critical factors:

1. Although only 13 per cent of all railroad mileage belongs to bankrupt railroads, essentially all of this is located in the Northeast. Some 80 to 88 per cent of all railroad trackage in the three states of this judicial circuit is in

[1] Circuit Judge Maris and District Judge Gorbey, other members of the original panel, did not sit on the court en banc. Judge Maris was temporarily ill. District Judges are not authorized to sit on en banc rehearings in the courts of appeals.

the process of financial reorganization.[2] Once this fact of 1973 life is recognized, it strains credulity to accept the majority's implication that the Interstate Commerce Commission, a government agency charged with the supervision of these railroads, has the capacity or capability of bringing about a "resurrection of railroads in reorganization." (Majority slip opinion, 10). Putting aside a spiritual miracle, that resurrection can be brought about only by federal and state financial aid. Although the majority seem unwilling to recognize this, the Congress and the New Jersey legislature have.

2. The majority approach this case as if the Rail Passenger Service Act of 1970, 45 U. S. C. §§ 541-548 had never been enacted. That was a legislative declaration of national railroad policy proclaiming that inter-city passenger service would be forced to cease, unless federal financial assistance was forthcoming. Reasons cited for this crisis were competition from 90 million automobiles and multiple schedules of competitive jet air service which directly competed with passenger transportation.[3] The decline of railroad freight business also diminished the passenger carrying capabilities of the railroads. Traditional

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[2] Without question we face a short-term rail crisis in the Northeast. Six of the rail carriers in this area are in bankruptcy, and the dominant one—the Penn Central—is on the verge of Court ordered liquidation in order to prevent further erosion of the creditors' estates. Correcting this short-term problem will require cooperative and public-spirited action by all parties involved—Congress, the Administration, regulators, labor, creditors, shippers, *and the courts*. (My emphasis.)

Department of Transportation (DOT) Report to Congress, Northeastern Railroad Problem, March 26, 1973, submitted by the Secretary of Transportation in response to S.J. Res. 59-2, Page 5.

[3] Legislative History, House Report No. 71-1580. U.S. Code Cong. & Admin. News, 4735 (1970).

railroad freight business was lost to inland waterway operations, pipelines and trucks. Moreover, government policy tended "to favor non-rail transportation and perpetuate a regulatory climate that [was] hostile to experimentation." Water, air and highway transportation were successfully aided through public investment, at little or no user cost while railroads had to make such investments on their own.[4]

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[4] Staff Report, "The Penn Central and Other Railroads," Senate Committee on Commerce, December 1972, at 220-222:

> . . . In 1929 the railroads were the country's dominant form of commercial transportation, hauling most of the freight and moving most of the people traveling by public means between cities. Reflecting their preeminent transport role the railroads were generally in sound financial health, with their earnings making their debt and equity securities widely respected forms of investment.
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> By 1970 . . . the posture of the railroads was radically different. Moving only a little more than 40 per cent of the nation's intercity freight and only a tiny fraction of intercity passengers, the railroads were no longer the primary form of transportation in the United States . . . .
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> . . .
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> . . .
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> . . . The mining/forestry/agricultural sectors, which have long been the primary generators of rail freight traffic, have declined in relative importance, with their rates of growth generally lagging behind the overall rate of economic expansion. Faster rates of growth have come in manufacturing, but the railroads have been unable to adjust their service to attract this traffic (and revenue) needed to offset the relative losses sustained due to the slower growth in the low-value bulk-goods sectors.
>
> Meanwhile, other modes of transportation—in part because of their technological advances, in part because of the provision of government infrastructure—have provided increasingly tough competition for the railroads. The inland waterway operators and the pipelines have diverted some bulk traffic and the trucks have taken a large share of higher-valued manufactured goods traffic. Pinched from both sides, the railroads' position has been weakened, with the greatest harm coming in the manufactured goods area since here the rates of growth

Appendix A

For three years Amtrak has been operating inter-city lines, with federal financial assistance by use of outright grants, 45 U.S.C. § 601; guarantee of loans, 45 U.S.C.

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in output (and thus in traffic) have been the fastest (and promise to be so in the future) and the yields are the most substantial. Here also, though, competition is intense because service factors (speed, schedule reliability, etc.) are substantial, often even more so than tariffs . . . .

On the regulatory side existing government controls, at the State as well as the Federal level, continue to be more oriented to the protection of the transport status quo than to the creation of an environment favorable to change . . . . Such approaches require a sympathetic climate, one that reacts promptly to proposals and that reflects a willingness to permit experimentation. Existing regulation is almost a contradiction of these essential features. It is slow, cumbersome, passive, and protective—qualities that reflect deeply ingrained legal standards, cumulative regulatory attitudes, and a status quo outlook that permeates the entire transport environment.

The views of the Senate staff committee are echoed by the Department of Transportation:

From a meager start in about 1830, the Nation's rail industry moved ahead rapidly following the Civil War. The decade of greatest expansion in railway trackage was the 1880's. By 1890, nearly two-thirds of our railway mileage was in place. Railway mileage peaked in 1916 when there were 254,000 miles of railway in the United States.

As the industry matured, its overal growth rate slowed drastically and in the Northeast it has actually declined since 1947. The root of the decline lies in the railroads' changing economic and regulatory environment and the industry's inability to adapt adequately to the changes.

As strong intermodal competition developed, the railroads' intercity freight and passenger markets suffered. Coal's losses to oil, which is transported primarily by pipeline, was another blow to the railroads. Northeastern railroads in particular were hard hit after World War II by the losses to the South and West of industries dependent on heavy freight movements. The diminishing importance of the agricultural, forestry and mining industries in the Northeast, and the shift to a post-industrial service type economy, also hurt. . . .

One of the most important developments affecting the railroads, particularly in the Northeast, was the growth of the

§ 602; and emergency financial assistance, 45 U.S.C. § 621.[5] Actual federal appropriations to Amtrak to date have been $210,000,000 in grants and $100,000,000 in guaranteed loans.

But Congress was careful to distinguish between intercity passenger lines, which come under federal financial support, and commuter lines—the passenger service involved in this appeal—which come under state supervision.

3. Passenger service on intrastate commuter lines traditionally has not been subject to federal regulation. Com-

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intercity trucking and barge industries. Before the advent of large, efficient trucks, the rails had put down thousands of miles of line and were serving virtually every economically important sector of the Northeast. But an exhaustive network of modern highways built in recent years has tied the big cities together and enabled the motor carriers to capture most of the short haul and medium hall non-bulk commodity traffic from the rails.

At the same time, motor carrier competition, with its constant threat of diverting traffic, has helped to place a ceiling on rail rates. Thus, even though the amount of freight traffic carried by the railroads has expanded as the economy has expanded, the average rail revenue per ton-mile in 1970 was two persent less than in 1958. Although the introduction of piggyback service and tri-level auto cars in the late 1950's allowed the railroads to recover or retain some medium haul traffic, it was not enough to enable them to hold their own against the trucks.

Railroads have also suffered in recent years from government policies which have favored non-rail modes. This has permitted these modes to improve their productivity and quality of service. In addition, many state and local governments have taxed railroads at a higher rate than other industries, and rails currently pay a higher proportion of their gross revenues in taxes than do motor carriers.

DOT Northeastern Report, note 2, *supra*, at 9-11.

[5] Section 601 authorizes an appropriation of $40,000,000 for 1971, and $225,000,000 for subsequent years. Under § 602 loans may be guaranteed up to $150,000,000 before July 1, 1973, and up to $200,000,000 thereafter. Emergency loans and guaranties may aggregate $200,000,000 under § 621.

muter service generally is regulated by the state public utility commission. The commuter service in this appeal is no exception.

4. Amtrak federal financial aid which is available to inter-city lines, not being available to commuter lines, it became incumbent upon the states to support beleagured commuter lines much in the same manner that the federal government came to the support of the inter-city lines. "[Amtrak] will undertake the responsibility for providing the rail passenger service of the future, and it will be free to go beyond the original base system, particularly *where State, regional, or local authorities are willing to provide financial assistance for service which they desire.*"[6] The same factors described in 2 which caused the problems in inter-city lines caused the financial crunch in commuter lines. Thus, New Jersey enacted legislation to subsidize continued rail commuter services. 27 N.J.S.A. 1A-18 (1973 Supp.). For 1973 New Jersey's total commuter subsidy amounts to $14,948,913, of which the CNJ subsidy amounts to $5,115,101.[7]

5. The New Jersey subsidy thus far has been based on an "avoidable loss" figure computed by determining whether a particular cost would be avoided if passenger service were discontinued. The New Jersey legislature

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[6] Legislative History, *supra*, note 3, at 4737.

[7] For fiscal 1972-1973 Pennsylvania's commuter subsidies included:

Penn Central	$4,872,350
Reading	4,333,333
SEPTA administrative expenses	300,000

Pennsylvania has not contributed one cent to commuter support for CNJ.

Appendix A

"[i]n order to conserve and improve passenger service necessary for public use . . . in this state," authorized the payment "of the full cost of such passenger service. . . ." Section 18 of P.L. 1966, c. 301 (C. 27:1A-18) effective July 18, 1972. Significantly, the introductory statement to this legislation declares:

> This bill changes the present law to allow the commuter operating agency to compensate carriers for rail passenger service up to the full cost of providing such service rather than on the present avoidable loss basis. It also authorizes payment on a current basis rather than on a reimbursement basis. These changes are necessitated by recent Federal court rulings in connection with the reorganization of the Pennsylvania Central Railroad. It is likely that the full cost of service basis will become the standard required by the courts as a prerequisite for allowing railroads in the process of a reorganization to continue to provide passenger service.

II.

I now turn to the litigation at hand. This case is purely and simply a push and pull squabble between the Trustee of CNJ and the State of New Jersey over the amount of the commuter subsidy. The railroad needs more commuter subsidy from the state. The state is only paying "avoidable loss" subsidies, although the legislature has authorized payment of the "full cost." The technical roadblocks thrown up by the State to avoid paying its responsibility now—the insistence of a prior resort to state or federal administrative agencies—were cast aside by Judge Augelli in the district court. He ordered the

parties to come to an agreement or else he would order abandonment. When New Jersey failed to implement its statutory authority, the court issued the order. The original panel of this court affirmed. On rehearing the majority have now replaced the roadblocks so that New Jersey can get a free ride during the useless, futile and excruciatingly delayed administrative proceeding at the expense of the bondholders and mortgagees whose property is now being taken, in my view, without due process of law.

An example of the delay envisioned by the majority's action was expressed by a Commonwealth of Pennsylvania brief in another appeal in this court.[8] Asking this court to order resumption of service on Penn Central trackage which had been permanently damaged by Hurricane Agnes, the Commonwealth of Pennsylvania asked this court *not to wait* until ICC determination: "The final I.C.C. decision—and judicial review thereof—are several years distant." As recent as March 26, 1973, the Department of Transportation (DOT) complained to Congress about the delay inherent in abandonment proceedings associated with the "Northeastern Railroad Problem":

> Federal and state regulatory policies have made it difficult for the railroads to adapt to changing economic and competitive conditions. The Interstate Commerce Act seems especially in need of modification and incorporation of regulatory relief in the following areas.
>
> 1. *Abandonment*
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> Lengthy procedures often prevent or unnecessarily hinder a railroad's efforts to abandon branch or other

[8] *Commonwealth of Pennsylvania* v. *Baker*, —— F.2d —— (3d Cir., No. 72-2055, 1973) (Commonwealth brief, 13).

lines that can no longer cover even variable costs. Hearings, briefs, rebuttals, and other procedures may delay abandonments for years—all the while forcing the railroad to provide the service at a loss . . . .[9]

III.

Whatever disagreement there may be on the specifics of reorganizing railroads, one thing appears clear: "Current public policy is deficient. Government action will be required in a variety of efforts so that the industry is better able to respond to changing circumstances. The present structure and organization of the private sector along with

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[9] DOT Northeastern Report, *supra*, note 2, at 22.

In a more comprehensive report, on the Rail Passenger Service Act (Amtrak) dated March 15, 1973, DOT explained:

> In the case of operating wholly within a single state, Amtrak must seek permission to discontinue from an appropriate state authority before seeking permission to discontinue from the ICC. In such a case, the findings which the ICC must make in order to authorize discontinuance are slightly different and, while pendency of the state proceeding may not bar Amtrak from seeking authority to discontinue from the ICC for more than 120 days, there is no time limit placed on the ICC's power to delay the discontinuance. Indeed, there can be no discontinuance in a case of this type until the ICC has authorized it. Decisions of the Commission under Section 13a are reviewable by a three-judge District Court pursuant to Sections 1336, 1398, 2321-25 and 2284 of the Judicial Code (29 U.S.C.). Decisions of a three-judge District Court are reviewable by appeal in the Supreme Court pursuant to 28 U.S.C. Section 1253. This review process can add as much as two or three years to the period of time during which Amtrak must continue to provide an uneconomic low patronized service.
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> Recommendation: The discontinuance procedure should be changed to avoid continuing uneconomic service, through an extended period of litigation.

DOT Amtrak Report, 104-105.

the public policy too often fail to meet public needs for rail transportation." [10]

Significantly, the Department of Transportation reported to Congress on March 13, 1973, a recommendation for a federal grant of $93,000,000 for Amtrak to underwrite operating losses for fiscal 1974, an increase in loan guarantees, open-ended authorization not to exceed $500,000,000. "It is the judgment of both Amtrak and DOT that, at this time, other than federal grants and loan guarantees there is no source from which Amtrak can fund its operating losses and meet its capital requirements. Given the losses in FY 1972 and FY 1973 Amtrak is not in a position to issue stock or incur debt without Federal guarantees." [11]

Similarly, the New Jersey Department of Transportation, in a statement implementing its "plans for the preservation and improvement of the commuter railroad system" reported the following expenditures:[12]

	Operating Assistance	
	Contract Amt.	*Contract Amt.*
Railroads	*Fiscal 1973*	*Fiscal 1961-72*
Penn Central	$ 51,600	$ 9,847,642
Erie Lackawanna	9,106,000	44,843,260
Central Railroad	5,115,101	42,290,774
Penn-Reading S.L.	676,212	2,471,798
TOTALS	$14,948,913	$99,453,474

[10] Staff Report, *supra*, note 4, at 189.

[11] Staff Report, *supra*, note 4, at 100.

[12] Pamphlet, The New Jersey Department of Transportation, "What it is . . . what it does," 1973.

Hopelessly dependent upon such current massive aid from federal and state sources, 1973 railroad problems cannot be considered in the context of conditions 40 years ago.[13] I cannot read Supreme Court decisions relating to this phase of railroading in 1939 as being viable in 1973. I cannot read Section 77(o) of the Bankruptcy Act, 11 U.S.C. § 205, with the strictures arbitrarily imposed by the majority. The rationale of *Palmer* v. *Massachusetts*, 308 U.S. 79 (1939), was articulated in an era when American passenger railroads were a part of the private sector of American industry, and not dependent for survival on massive infusion of federal monies for inter-city lines and state monies for commuter lines.[14] I also recognize that insofar as ICC jurisdiction is concerned, DOT has announced that "Amtrak, under its Congressional charter, differs substantially

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[13] "In 1929, there were some 20,000 passenger trans in the United States. Nine thousand of these had disappeared by 1946. Here in 1970 there are less than 500 and over 100 of these are presently in the process of discontinaunce proceedings before the Interstate Commerce Commission. Many of the existing passenger trains are operating under heavy and continuing deficits. The committee regretfully recognizes that a large number of them hold no promise for financial success in the foreseeable future." Legislative History, *supra*, at 4736-4737.

[14] DOT has reported to Congress:

> The industry's history is rife with bankruptcies. As one would expect, the largest number of them resulted from the Great Depression when at one point in the 1930's, 33 percent of all railroad miles were in receivership. At the present time, 13 percent of all railroad mileage operated belongs to bankrupt railroads—essentially all located in the Northeast. *However, the two situations are different in that the bankrupt railroads in the 1930's still had some earnings around which they could, and in fact did, reorganize.* Today the outlook is less favorable.

(Emphasis supplied.) DOT, Northeastern Report, *supra*, note 2, at 11.

from the individual rail carriers which provided service prior to May 1, 1971."[15] DOT has recommended elimination of ICC review of discontinuances of service required by the basic system and clarification of the lack of jurisdiction over other aspects of Amtrak operations.[16] The staff

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[15] DOT Amtrak Report, *supra*, note 9, at 107.

[16] DOT Amtrak Report, *supra*, note 9, at 7, 107-09. Additionally, DOT has found:

Unlike other bankrupt industries, bankrupt railroads have not been allowed to reorganize and modernize their operations. Plant and equipment is not dismantled, nor the land and other properties sold, the way other businesses that go through bankruptcy are liquidated. Despite the large number of miles of road in receivership, only an average 0.4 percent of the total road mileage has been abandoned annually since 1916, the peak year. Rail bankruptcies have not been treated as a sign that the industry had fundamental problems (such as over-capacity in a non-growth industry) which needed correction. Nor have they been used as an opportunity to help correct the problems by allowing some of the bankrupt roads, or perhaps major parts of them, to go out of existence. Instead, railroads were deemed too important to the economy to be discarded. It was felt that the companies could be made viable simply by reducing their debt structure or merging them with healthier roads. This patchwork policy has maintained essentially the same railroad network which was in place in 1920, *one which was geared to the environment and economy of the late 19th and early 20th century.*

The gradual broadening of the Interstate Commerce Act to increase regulatory controls has had a similar restrictive impact on the railroads. The continuing decline of the railroads as an industry, the financial plight of the railroads in the Northeast, and the inflexibility of response to competitive conditions in the marketplace have, in part, been brought about by the regulatory restrictions of the Interstate Commerce Act.

Regulatory practices have adversely affected railroads in many ways. They have permitted, even encouraged, abuses of "value of service" pricing and freight car utilization in ways that have led to a serious misallocation of transportation resources. Probably more important, regulatory practices have produced a rigid pricing structure which, for rails in particular, has prevented them from responding to the needs of a changing market. *In addition, outmoded regulations have impeded efficiency within a given mode by*

report to the Senate Committee on Commerce speaks to "changes in approach" of section 77. "Attention should be given to overhauling the Act so that it provides sufficient authority for addressing transportation problems as well as financial problems."[17] And it seems to me that the very same reasons why "Amtrak . . . differs substantially from the individual rail carriers which provided service prior to May 1, 1971," apply with equal vigor to CNJ. Amtrak is dependent upon federal financing; CNJ, upon New Jersey financing. This governmental financing, so essential to modern railroad survival, constitutes the critical difference. Therefore, CNJ can be said to differ "substantially" from the pre-1971 carriers; and because of this difference the factors which controlled *Palmer* in 1939 are not applicable here in 1973.

IV.

CNJ has been in reorganization pursuant to Section 77 of the Bankruptcy Act since March 22, 1967. The financial difficulties of this Railroad, however, long antedate the current reorganization. The CNJ has been operating with substantial annual deficits since 1958. The table in the

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restricting competition and by discouraging the abandonment of uneconomic branch lines.

The Administration has pointed out in three successive Economic Reports to the Congress (1970, 1971, 1972) that economic and competitive conditions have changed considerably since regulation began in 1887, and that changes have not been adequately reflected in the regulations governing surface freight transportation. The Department of Transportation believes that regulatory reform is fundamental to any plan to restructure the railroads of the Northeast.

(Emphhsis supplied.) DOT Northeastern Report, *supra*, footnote 2, at 11-13.

[17] Staff Report, *supra*, note 4, at 189.

margin lists those deficits.[18] The deficit for the first ten months of 1972 approximated $8 million.

CNJ's trustee tells us:

> There is no dispute between the parties about CNJ's history of deficits; and, indeed, the State of New Jersey apparently believes CNJ to be in a more perilous financial position than does the Trustee. Subsequent to the hearing, on December 29, 1972, the New Jersey Department of Transportation issued a report on "The Jersey Central Situation" which contained the following statement:
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> Complete collapse of the Central Railroad of New Jersey as an independent carrier with resultant disruption of its rail operations, both freight and passenger, appears to be inevitable without massively increasing public financial support.[19]

The reorganization court found that it was imperative for a new subsidy contract to be negotiated between CNJ and New Jersey. The court found that if the present New Jersey subsidy contract with CNJ were to continue, the rail-

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[18] 1958—$ 2,010,269
1959— 2,872,258
1960— 4,186,307
1961— 7,141,924
1962— 7,410,306
1963— 6,098,233
1964— 8,254,389
1965— 6,665,192
1966— 7,451,052
1967— 13,616,041
1968— 7,951,641
1969— 9,381,372
1970— 14,848,200
1971— 7,695,058

[19] Appellee's brief, 4.

road will continue to lose $500,000 per month. The court found such losses to be "an erosion of assets that will result in an unconstitutional taking of the debtor's property." [20] If this is a finding of fact, I do not find it clearly erroneous; if a conclusion of law, I do not disagree with it.

V.

The doctrine of *Palmer*, relied on by the majority, simply cannot apply to a railroad described by the ICC as being *"in extremis,"* where the railroad no longer survives as part of the private sector, but is completely dependent upon a state commuter subsidy program in which New Jersey has had to furnish 99 million dollars from 1961 through 1972. The issue comes down to this: given the perilous erosion of assets of a state supported railroad, and a state legislative policy commanding "actual cost support," is a reorganization court without power to order abandonment of service where the state refuses to enter into a subsidy contract other than "avoidable loss" when the state's refusal is causing the railroad to lose $500,000 a month?

The district court has that power under § 77(a), 11 U.S.C. 205(a):

> [T]he court . . . shall have and may exercise in addition to the powers conferred by this Section, which a court of the United States would have had if it had appointed a receiver in equity of the property of the debtor for any purpose.

The majority relies on a strict construction of 77(o) which seems to require as a prerequisite to abandonment

[20] Appendix, 429a.

"the approval and authorization of the [ICC] Commission." I have heretofore observed that the strictures of this section have been considerably diluted by the change in the American economics and the railroad's role therein and the specific circumstances of this railroad, which may no longer be considered governmentally regulated private industry, which 77(o) was designed to serve. It is a co-partner with the state of New Jersey in a quasi-private, quasi-governmental enterprise. And it is providing passenger commuter service only because the State of New Jersey insists upon it.

There is sufficient evidence of a national railroad policy enunciated in the Rail Passenger Service Act of 1970 and sufficient evidence of a state railroad policy in the New Jersey commuter operating agency legislation to persuade me that this policy dictates that the state or federal agency must provide adequate subsidy of passenger services or the carrier may terminate those services. This policy makes application of § 77(o) to a situation such as that of CNJ unnecessary. Section 77(o) envisions some discretionary action on the part of the ICC or state commission on the basis of public convenience and necessity.

VI.

This leads inexorably to the fatal defect in the majority's approach: its insistence that there be exhaustion of statutory administrative remedies either to the ICC or the PUC before there may be judicial relief. In the fact of a constitutional claim of confiscation, because of the constantly eroding assets, calculated at $500,000 a month, acknowledging that resort to administrative proceedings is an elaborate, time-consuming process, possibly taking years, (*ante*, page 53a, n.9), a requirement of initial

resort to an administrative agency must have some purpose; some reason for the exercise of administrative discretion by reason of agency expertise. Laid bare, the heart of the problem is to ascertain what discretion still abides under the moribund financial circumstances confronting CNJ.

The ICC itself has conceded the necessity for some "drastic remedial action" in a proceeding entailing abandonment of certain CNJ lines in Pennsylvania:

> The overriding factor with which we are faced, is that since 1967, CNJ has been debtor in reorganization under the Bankruptcy Act before the United States District Court for the District of New Jersey. Its position has continuously deteriorated, as have other railroads serving the New York metropolitan area. CNJ now may be considered *in extremis*. During and since 1970, its losses have amounted to more than $1 million per month. Under the circumstances, some form of drastic remedial action became imperative.[21]

The dire financial condition of CNJ is not controverted by the State of New Jersey. The state has offered no suggestion by brief, nor at either of the two oral arguments of this case that the ICC or the PUC has the ability to fashion any relief other than that specifically ordered by Judge Augelli: increase the state subsidy or abandon the service.

Why then, the stubborn demand for an exercise in futility? What principle of current law has ever justified this? The philosophy condemned by Roscoe Pound as

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[21] ICC Conclusions at 288, cited *In the Matter of Central Railroad Company of New Jersey, Debtor, Pennsylvania, Appellant,* —— F.2d —— (3d Cir., No. 73-1110, Slip Opinion fn. 3).

mechanical jurisprudence would have justified blind application of *Palmer* to this case: "Legal systems have their periods in which science degenerates, in which system decays into technicality, in which a scientific jurisprudence becomes a mechanical jurisprudence."[22] The effect of *Palmer's* application to these circumstances would be in Pound's words "petrifaction of the subject systematized . . . [that] tends to cut off individual initiative in the future, to stifle independent consideration of new problems and of new phase of old problems, and to impose the ideas of one generation upon another."[23]

But the warning of Pound has been heeded. Modern jurisprudential teachings have accepted Pound's adoption of Ihering's thesis: "[T]he first question should be, how will a rule or decision operate in practice?"[24] Obviously, I have deep misgivings about the result reached by the majority. At the same time, I am quick to recognize that it is for the court to interpret law, and not to legislate. "Legislation is enacted to regulate the social and legal environment of a living society. [But, as] Gény points out, to apply it to unforeseen or substantially changed conditions of other times, even though the original statutory purpose is no longer served, is to apply mechanically an abstract formula which no longer represents the will of the legislature . . . . In essence, then, the words of legislation contain a principle of regulation intended by the legislators to apply to contemplated norms of their own and succeeding times. But if there is a substantial change

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[22] Pound, *Mechanical Jurisprudence*, 8 COL. L. REV. 605-607 (1908).

[23] Pound, *supra*, at 606.

[24] Pound, *supra*, at 610.

in the social [and economic] condition the statute is designed to regulate, the mechanical adjudication by reference to the statute's literal wording alone may, under the changed conditions, amount to an irresponsible application of a legal rule devised neither by legislative intent nor by the deciding court."[25]

Roger Traynor tells us:

> The responsibility to keep the law straight is a high one. It should not be reduced to the mean task of keeping it straight and narrow. We should not be misled by the cliché that policy is a matter for the legislature and not for the courts. There is always an area not covered by legislation in which the courts must revise old rules or formulate new ones, and in that process policy is often an appropriate and even a basic consideration.[26]

Both the Department of Transportation and the Senate staff to the Committee on Commerce have graphically delineated the fundamental changes in railroad industry which have occurred essentially since World War II in this nation and have especially affected the Northeast. (*Ante*, note 4). This critical data, plus the enactment of the new national railroad passenger policy by Congress in 1970 and the new New Jersey legislative policy as reflected by the state commuter agency persuade me that the strictures of 77(o) as interpreted by *Palmer* do not apply to the circumstances of this case.

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[25] Tate, *The Law-Making Function of the Judge*, 28 LA. L. REV. 211, 228 (1968).

[26] Traynor, *Some Open Questions on the Work of State Appellate Courts*, 24 U. OF CHICAGO L. REV. 211, 219 (1957).

In sum, what divides this court is what Justice Walter V. Schaefer, Illinois Supreme Court, has described as a difference in "the judge's unspoken notion as to the function of his court. If he views the role of the court as a passive one, he will be willing to delegate the responsibility for change, and he will not greatly care whether the delegated authority is exercised or not. If he views the court as an instrument of society designed to reflect in its decisions the morality of the community, he will be more likely to look precedent in the teeth and to measure it against the ideals and the aspirations of his time." [27]

We can agree that resort to an administrative agency is not mandated "[w]hen there is nothing to be gained from the exhaustion of administrative remedies and the harm from the continued existence of the administrative ruling is great." *Wolff* v. *Selective Service Local Board No. 16*, 372 F.2d 817, 825 (2d Cir. 1967). "[T]he exhaustion requirement contemplates an efficacious administrative remedy, and does not obtain when it would come to no more than an exercise in futility." *Lodge 1858, American Federation of Government Employees* v. *Paine*, 436 F.2d 882, 896 (D.C. Cir. 1970). "The requirement that a plaintiff exhaust administrative remedies before applying for judicial relief pre-supposes that the remedy is an effective one." *Northeastern Pennsylvania Nat'l Bank and Trust Co.* v. *Sandvick Steel, Inc.*, 325 F. Supp. 651, 655 (M.D. Pa. 1971). *See also, McKart* v. *United States*, 395 U.S. 185, 199 (1968); 3 K. Davis, ADMINISTRATIVE LAW § 20.07 (1958) at 97. "Whether to require exhaustion is discretionary. If pursuing an administrative remedy would be futile, the requirement may be waived. *City Bank Farmers Trust Co.*

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[27] Schaefer, *Precedent and Policy*, 34 UNIV. OF CHIC. L. REV. 3, 23 (1966).

v. *Schnader*, 291 U.S. 24, 34 (1934); *see* 3 *Davis, Administrative Law Treatise*, § 20.07, at 99 (1958)." *United States ex rel. Marrero* v. *Warden, Lewisburg Penitentiary*, — F. 2d — (3d Cir., No. 72-1842, — 1973). (Slip opinion at page 4.)

VII.

Thus it comes to this. Theoretically, the administrative agencies have discretionary authority to approve or disapprove the request for abandonment. Actually and realistically their discretion is non-existent, because of the *in extremis* condition of CNJ. "To compel it to go on at a loss . . . would be to take its property without the just compensation which is a part of due process of law. The controlling principle is the same that is applied in the many cases in which the constitutionality of a rate is held to depend on whether it yields a fair return." *Railroad Commission of Texas* v. *Eastern Texas Railroad Company*, 264 U.S. 79, 85 (1923).[28]

The statutory purpose of 77(o) cannot be applied to a situation where resort to an administrative body is a hopeless, useless gesture which exalts form over substance. This is my interpretation of 77(o), albeit one that does not rest on the literal wording of the statute. But there is recent precedent for a non-literal interpretation of Section 77(o). Recently this court, also speaking through Judge Adams, has interpreted Section 77(o) to mean that the trustees of Penn Central had no authority to sell real estate, even

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[28] Citing *Brooks-Scanlon Co.* v. *Railroad Commission of Louisiana*, 251 U.S. 396, 399; *Bullock* v. *Railroad Commission of Florida*, 254 U.S. 513, 520; *State ex rel. Cunningham* v. *Jack*, 113 Fed. 823; s.c. 145 Fed. 281; *Iowa* v. *Old Colony Trust Co.*, 215 Fed. 307, 312; *Northern Pacific R.R. Co.* v. *Dustin*, 142 U.S. 492, 499; *Commonwealth* v. *Fitchburg R.R. Co.*, 12 Gray, 180, 190; *State* v. *Dodge City, etc. Ry. Co.*, 53 Kan. 329, 336.

though approved by the reorganization court, notwithstanding the explicit language of that section sanctioning the sale. Judge Adams emphasized that "the Court had had to grapple with the problem presented here wherein a section of a statute states a proposition that if read *in vacuo* would appear incompatible with the congressional directive manifested by the entire statute." [29] I suggest that the same considerations which influenced the court to depart from an *in vacuo* approach in Penn Central should be applicable here. I do not believe this court should be a strict constructionist with CNJ and a free spirit constructionist interpreting the *very same section, 77(o)* in Penn Central. As the court examined the Congressional policy there, it should have with equal vigor examined the overall national and New Jersey railroad policy of 1973.

Indeed, I believe my interpretation is the only one which, under these circumstances, will preserve the constitutionality of 77(o). If the majority's interpretation of 77(o) is correct, then the statute is per force unconstitutional as to the 3¼% Mortgage Bondholders' Protective Committee and the Manufacturer Hanover Trust Company, indenture trustee of the CNJ's only general mortgage bond issue. Given the finding of a monthly loss of $500,000, from this operation, the overall monthly loss of the CNJ of $1,000,000 as found by the ICC, emphasizing the admission by New Jersey that "complete collapse of the Central Railroad of New Jersey as an independent carrier with resultant disruption of its rail operations, both freight and passenger, appears to be inevitable without massively increasing public financial support," considering the new

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[29] *In the Matter of Penn Central Transportation Morgan Guaranty Trust, Appellant* (3d Cir., Nos. 72-2116/26, June 14, 1973). Slip Opinion, 26.

national and state railroad policy, and recognizing that any resort to the PUC or the ICC would be a useless act, knowing that the only viable alternatives are (1) more subsidies from New Jersey, or (2) an abandonment of services, the interpretation of 77(o) as articulated by the majority makes that statute unconstitutional in that it deprives the bondholders and the mortgagee of due process of law because it confiscates their property.

The majority state that our task is to apply the statute until it "inexorably conflicts with the Constitution" and that "such conflict has [not] happened here—at least, not as yet." My disagreement with the majority is that I believe that the conflict is now at hand.[30] The majority have expressed an idea whose time has come.

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[30] The majority devote sixteen pages of an extremely erudite opinion setting forth reasons why strictures of Section 77 as interpreted by *Palmer* v. *Massachusetts* make it impossible for any court to afford relief even in the presence of an unconstitutional taking of property. Suddenly, in the penultimate paragraph, an entirely new theory is advanced, augmented by footnote 42, stating that "the point of taking, in the sense of due process, has not yet been established so as to justify a deviation from the mandate of Section 77."

A fair reading of this footnote suggests that the majority have now embraced the conceptual underpinnings of this separate dissenting opinion. They seem to say that an affirmance of the reorganization court is not appropriate because, although it was an action taken to prevent an unconstitutional taking of the bondholder's and mortgagee's property, the order was premature because the precise moment of unconstitutional taking had not yet arrived.

Supporting this interesting concept is a compilation of excerpts of bench comments which emphasize *per verba de futuro*. Thus, what apparently divides this appellate court is the emphasis to be placed on grammatical tense utilized by the reorganization court in certain oral statements: had that court used *per verba de praesenti* another result would be mandated. Stated as a legal principle, this suggests that (1) the reorganization court is powerless to prevent an unconstitutional taking, and (2) it can act to

I would affirm the order of the district court.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

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prevent a confiscation only after the confiscation has taken place. My difficulty in accepting such a notion is manifest.

I think this is too serious a matter to exalt form over substance. Under the supervision of federal courts—from 1967 through the first eight months of 1972 (as limited by this case record)—CNJ has lost sixty-two million dollars. The ICC reports: "CNJ now may be considered *in extremis*, during and since 1970 its losses have amounted to more than $1,000,000 a month." (*Ante*, page 50a.)

These brute statistics are chilling. They cry out for action; not for an exercise in logomachy.

Appendix A

Sur Petition for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 73-1006 and 73-1027

In the Matter of

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Debtor,

No. 73-1006

Appeal of State of New Jersey

No. 73-1027

Appeal of Commonwealth of Pennsylvania
and Pennsylvania Public Utility Commission

(D. C. No. 401-67 Bankruptcy)

Present:

SEITZ, *Chief Judge,* VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN, HUNTER and WEIS, *Circuit Judges*

The petition for rehearing filed by Appellee, R. D. Timpany, Trustee, in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular

active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

By the Court,
/s/ ARLIN M. ADAMS
Circuit Judge

Dated: October 3, 1973

APPENDIX B

United States Constitution, Amendments 5 and 14, Section 1

Amendment 5

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; or shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Amendment 14, Section 1

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Appendix B

Bankruptcy Act, Section 77(a), (c)(3), (l)
11 U.S.C. 205(a), (c)(3), (l)

(a) Any railroad corporation may file a petition stating that it is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization. The petition shall be filed with the court in whose territorial jurisdiction the corporation, during the preceding six months or the greater portion thereof, has had its principal executive or operating office, and a copy of the petition shall at the same time be filed with the Interstate Commerce Commission (hereinafter called the "Commission"). When any railroad, although engaged in interstate commerce, lies wholly within one State, the proceedings shall be brought in the United States district court for the district in which its principal operating office has been located during the preceding six months or the greater portion thereof. The petition shall be accompanied by payment to the clerk of a filing fee of $150. Upon the filing of such a petition, the judge shall enter an order either approving it as properly filed under this section, if satisfied that it complies with this section and has been filed in good faith, or dismissing it, if he is not so satisfied. If the petition is so approved, the court in which the order is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a court of the United States would have had if it had appointed a receiver in equity of the property of the debtor for any purpose. Process of the court shall extend to and be

valid when served in any judicial district. The Supreme Court of the United States shall promulgate rules relating to the service of process outside of the district in which the proceeding is pending, and any other rules which it may deem advisable in order to aid district courts and courts of appeal in exercising the jurisdiction herein conferred upon them. The railroad corporation shall be referred to in the proceedings as a "debtor". Any railroad corporation the majority of the capital stock of which having power to vote for the election of directors is owned, either directly or indirectly through an intervening medium, by any railroad corporation filing a petition as a debtor may file, with the court in which the other debtor has filed such a petition, and in the same proceeding, a petition, a copy of which shall also be filed at the same time with the Commission, stating that it is insolvent or unable to meet its debts as they mature, and that it desires to effect a reorganization in connection with, or as a part of the plan of reorganization of the other debtor; and upon the filing of the petition, the judge shall enter an order either approving it as properly filed under this section, if satisfied that it complies with this section and has been filed in good faith, or dismissing it if not so satisfied, and thereupon the court, if it approves the petition, shall have the same jurisdiction with respect to such debtor, its property and its creditors and stockholders, as the court has with respect to the other debtor. Creditors of any railroad corporation, having claims aggregating not less than 5 per centum of all the indebtedness of the corporation as shown in the latest annual report which it has filed with the Commission at the time when the petition is filed, may, if the corporation has not filed a petition under this section, file with the court

in which the corporation might file a petition under this section, a petition stating that the corporation in insolvent or unable to meet its debts as they mature and that the creditors have claims aggregating not less than 5 per centum of all such indebtedness of the corporation and propose that it shall effect a reorganization; copies of the petition shall be filed at the same time with the Commission and served upon the corporation. The corporation shall, within ten days after such service, answer the petition. If the answer admits the jurisdiction of the court and the material allegations of the petitions, the judge shall enter an order approving the petition as properly filed if satisfied that it complies with this section and has been filed in good faith, or dismissing it, if not so satisfied. If the answer denies either the jurisdiction of the court or any material allegation of the petition, the judge shall summarily determine the issues presented by the pleadings without the intervention of a jury, and if he finds that the material allegations are sustained by the proofs and that the petition complies with this section and has been filed in good faith, the judge shall enter an order approving the petition; otherwise, he shall dismiss the petition. If such a petition is so approved, the proceedings thereon shall continue with like effect as if the railroad corporation had itself filed a petition under this section. If a petition is dismissed, neither the petition nor the answer of a debtor constitute an act of bankruptcy or an admission of insolvency or of inability to meet maturing obligations or be admissible in evidence, without the debtor's consent, in any proceedings then or thereafter pending or commenced under this title or in any State or United States court. If, in any case in which the issues have not already been tried under the provi-

sions of this subdivision, any of the creditors, prior to the hearing provided for in paragraph (1) of subsection (c) of this section, appear and controvert the facts alleged in the petition, the judge shall determine, as soon as may be, the issues presented by the pleadings, without the intervention of a jury, and, unless the material allegations of the petition are sustained by the proofs, shall dismiss the petition.

(c) After approving the petition:

* * * * *

(3) The judge may, upon not less than fifteen days' notice published in such manner and in such newspapers as the judge may in his discretion determine, which notice so determined shall be sufficient, for cause shown, and with the approval of the Commission, in accordance with section 20a of Title 49, as now or hereafter amended, authorize the trustee or trustees to issue certificates for cash, property, or other consideration approved by the judge, for such lawful purposes and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, or receivership charges, as might in an equity receivership be lawful. Where such certificates are authorized to provide funds to pay for the acquisition, assembly or installation of safety equipment or materials related thereto, or for the purpose of reimbursing the trustee or trustees for funds so expended, the judge may direct (without limitation of his power to make such direction in the absence of this provision) that the certificates shall have such lien on the property of the debtor and shall be entitled to such priority in payments over existing obligations, secured or unsecured, and receivership charges and present or future duties, debts

or taxes or other obligations in favor of or payable to any State or any subdivision, agency or instrumentality thereof and interest or penalties, and to such parity with all or any portion of the other costs or expenses of administration or operation as in the particular case the judge may find equitable at the time of authorizing the issuance of such certificates, regardless of whether such obligations, charges, costs or expenses, duties, debts, or taxes constitute or are secured by liens on real or personal property or shall have become payable before or after the issuance of such certificates.

(*l*) In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed.

Interstate Commerce Act, Section 13a(2)
49 U.S.C. 13a(2)

(2) Where the discontinuance or change, in whole or in part, by a carrier or carriers subject to this chapter, of the operation or service of any train or ferry operated wholly within the boundaries of a single State is prohibited by the constitution or statutes of any State or where the State authority having jurisdiction thereof shall have denied an application or petition duly filed with it by said carrier or carriers for authority to discontinue or change, in whole or in part, the operation or service of any such train or ferry or shall not have acted finally on such an

application or petition within one hundred and twenty days from the presentation thereof, such carrier or carriers may petition the Commission for authority to effect such discontinuance or change. The Commission may grant such authority only after full hearing and upon findings by it that (a) the present or future public convenience and necessity permit of such discontinuance or change, in whole or in part, of the operation or service of such train or ferry, and (b) the continued operation or service of such train or ferry without discontinuance or change, in whole or in part, will constitute an unjust and undue burden upon the interstate operations of such carrier or carriers or upon interstate commerce. When any petition shall be filed with the Commission under the provisions of this paragraph the Commission shall notify the Governor of the State in which such train or ferry is operated at least thirty days in advance of the hearing provided for in this paragraph, and such hearing shall be held by the Commission in the State in which such train or ferry is operated; and the Commission is authorized to avail itself of the cooperation, services, records and facilities of the authorities in such State in the performance of its functions under this paragraph.

New Jersey Transportation Act of 1966
N.J.S.A. 27:1A-16, 17, 18, 20, 21, 22, 23, 24

27:1A-16.

(a) There is hereby established in the Department of Transportation the Commuter Operating Agency which for civil service purposes shall be considered to be a board.

(b) The agency shall consist of four members who shall be the Commissioner of Transportation, the assistant Com-

missioner for Public Transportation, the State Treasurer and the President of the Board of Public Utility Commissioners, or their respective designees.

(c) The Commissioner and the assistant Commissioner for Public Transportation shall be the chairman and secretary, respectively, of the agency.

(d) The commissioner shall assign to the agency such employees of the department as may be necessary for the efficient performance of the work of the agency in a division of commuter services under the supervision of the assistant Commissioner for Public Transportation. To assist the assistant Commissioner for Public Transportation in the conduct of the work of the agency, the commissioner, acting as chairman of the agency, may also appoint a director of commuter services who shall serve at his pleasure and whose duties he shall determine. The director of commuter services shall be a person qualified by training and experience in public transportation to perform the duties of his office, and shall receive such salary as may be established by the commissioner, with the approval of the President of the Civil Service Commission and the Director of the Division of Budget and Accounting, subject to the availability of funds.

(e) The powers of the agency shall be vested in the members thereof and three members of the agency or their designees shall constitute a quorum at any meeting thereof. Action may be taken and motions and resolutions adopted by the agency at any meeting thereof by the affirmative vote of at least three members or their designees. No vacancy in the membership of the agency shall impair the right of a quorum to exercise all the rights and perform all the duties of the agency.

(f) A true copy of the minutes of every meeting of the agency shall be delivered forthwith by and under the certification of the secretary thereof, to the Governor. No action taken at such meeting by the agency shall have force or effect until 10 days, exclusive of Saturdays, Sundays and legal holidays, after such copy of the minutes shall have been delivered. If, in said 10-day period, the Governor return such copy of the minutes with veto of any action taken by the agency or any member thereof at such meeting, such action shall be null and of no effect.

27:1A-17.

The agency annually shall investigate and determine the financial results to each rail carrier from providing passenger service during the previous calendar year and determine what action is required for each carrier to offset all or part of any loss shown. Such determination may include but shall not be limited to (a) changes in service, fares, operating procedures and routings (b) improvements to capital facilities and (c) compensation by the State for service to be rendered under a contract. The determination shall list the passenger service to be operated by a carrier under a contract and shall specify the fares to be collected for such passenger service; it shall also contain a list of projects to carry out the objectives of this act for which the commissioner recommends the use of public funds. Prior to making any such determination the agency may hold public hearings where it shall make known its proposed action to interested parties and the general public and receive from them any facts, material or recommendations that would be of assistance under the circumstances. All determinations shall be made public and filed with the Secretary of State not later than

June 15 in each year. Amendments to any determination may be made at any time and filed with the original determination.

27:1A-18.

In order to conserve and improve passenger service necessary for public use now and in future years in this State, but subject to the limitations of this act, the State of New Jersey, acting by and through the agency, may enter into contracts with any rail carrier, providing for acceptance by such carrier of all or any part of the agency's determination. Prior to entering into any such contract, the agency *shall* hold public hearings where it shall make known the terms and conditions of the proposed contract to interested parties and the general public. Every contract entered into pursuant to this section shall be subject to the following terms and conditions:

(a) Contracts involving expenditure of public funds for improvements to capital facilities shall require continuance of specified passenger service by the carrier for stated periods not limited to a fiscal year, and shall further require that title to such improvements shall be vested with the State, except that where public funds are expended to repair or rehabilitate existing facilities, such title to or other interest in such improvements as the carrier may have shall be the subject of negotiation between the agency and the carrier.

(b) No such contract shall provide for payments by the State to a carrier for service rendered in excess of the full cost of such passenger service less such setoffs and deductions as provided for in this act. Such contract may, however, provide for payments to the carrier for service

rendered on a current basis during the term of the contract. If during any contract period a carrier shall realize a profit from the passenger service contracted for, which profit exceeds a return on investment of 6%, ½ of the excess shall be paid to the agency. The accounting procedures to be employed to determine the extent of any profit or loss, as the case may be, shall be a subject of negotiation between the parties to the contract.

(c) Every such contract shall describe the passenger service which the carrier shall be required to operate. Such description shall set forth the operation of the contracted service which shall include timetables, train consists and fair tariffs applicable to the service and any other provisions that the agency may deem reasonable.

27:1A-20.

Each contract entered into in accordance with this act shall obligate the carrier:

(a) To operate passenger service on its lines or over tracks of other railroads in accordance with said contract, and to collect fares from persons (other than those employees of railroads or other persons allowed free passage or reduced fares in such passenger service under statutes heretofore enacted or under agreements hertofore made and now in effect) at the rates set forth in the fare tariffs included in such contract;

(b) To secure, keep in effect and abide by all approvals, orders or other proceedings of any State or Federal agency or court with respect to the contracted service;

(c) During the term of the contract and such further period as the contract may provide, unless otherwise approved in writing by the agency, not to initiate, take or

prosecute and to actively resist, any proceedings before any State or Federal agency or court for any order, approval, judgment, decree or other action impairing or limiting the rights, powers and capacity of the carrier to operate the contracted service and carry out and perform its obligations under said contract with respect to the contracted service;

(d) To maintain and operate passenger service required by virtue of the contract, equipment and all facilities incidental thereto in a safe, sanitary and proper manner and condition with a minimum of delays or cancellations and with maintenance of arrival and departure times for all stations and station stops; and

(e) To take all necessary action to initiate, expedite and complete within the stated time the improvements to capital facilities required by virtue of the contract.

27:1A-21.

Each contract entered into in accordance with this act shall obligate the State to pay to the carrier the amount agreed upon in the contract as compensation for service satisfactorily rendered provided the carrier has complied with the contract in all other respects to the satisfaction of the agency.

27:1A-22.

Each contract shall contain conditions, terms and provisions as the agency may require including, but not limited to, provisions permitting or relating to (a) determination of contracted service satisfactorily operated, (b) deductions or penalties with respect to unsatisfactory

service, (c) auditing and settlement of payments, (d) termination, waivers, release, modification or other effect in event of nonperformances, or of strikes, riots, disasters, acts of God or condition not caused or permitted by the carrier or within its control, (e) additional obligations of the carrier, and (f) any such other matters as the agency deems to be in the public interest. Any such contract may also provide for the rendering of additional service by the carrier, on an experimental basis or for an experimental period or otherwise, and for the payment by the State of additional compensation not exceeding the estimated actual cost of such additional service to the carrier, which additional compensation shall not be limited by the provisions of the first sentence of section 18(b).

27:1A-23.

Any contract may, from time to time upon mutual agreement of the parties, be amended to make changes in service or fares as permitted in section 24, in the manner in which the service required by the contract is to be operated by the carrier, or in the methods and procedures used to effectuate improvements to capital facilities required by the contract.

27:1A-24.

Every carrier or carriers entering into a contract shall be obligated to continue during the term of the contract all existing passenger service and fares applicable thereto, determined by the agency to be essential, except that the contract shall afford the carrier the right to petition the agency or the agency to move on its own motion for changes in passenger service, including extension, enlargement, curtailment or abandonment in whole or in part

and applicable fares during the term of the contract. If such a petition includes an application to decrease the number of trains or buses, a substantial change in schedules or an increase in fares, the agency, prior to making any determination with respect thereto, shall hold a public hearing on notice. In acting on any such petition the agency shall give due consideration to the following factors:

(a) The availability of alternative means of public transportation.

(b) The potential cost of continuing the service sought to be curtailed or discontinued.

(c) The cost to the State of providing alternative transportation facilities either by common carriers or highway improvement.

(d) The resulting effect on State and local population trends, economic values and tax revenues.

The authority hereby given the agency with respect to the discontinuance, curtailment, abandonment or change in fares or service shall be exercised during the contract period without regard or reference to the jurisdiction vested in the Board of Public Utility Commissioners by sections 48:2-21, 48:2-24 and 48:4-3 of the Revised Statutes. At the conclusion of the contract period the Board of Public Utility Commissioners shall resume such jurisdiction but no carrier shall be required to restore any service discontinued or fare changed unless the Board of Public Utility Commissioners shall determine, after notice and hearing, that the service or fare is required by public convenience and necessity.

Notwithstanding any other provisions of this act, all vehicles used by any motor bus carrier pursuant to con-

tract authorized by this section shall be subject to the jurisdiction of the Board of Public Utility Commissioners with respect to insurance, maintenance, specifications and safety to the same extent such jurisdiction is conferred upon by the board by Title 48, Public Utilities, as amended and supplemented.

1972 Amendment to New Jersey Transportation Act of 1966 (N.J.S.A. 27:1A-18)

CHAPTER 101

ASSEMBLY No. 1371

An Act to amend "An act establishing and concerning a Department of Transportation as a principal department in the Executive Branch of the State Government, establishing therein a commuter operating agency, providing an appropriation therefor, repealing chapter 88 of the laws of 1964, and supplementing Title 27 of the Revised Statutes," approved December 12, 1966 (P.L. 1966, c. 301).

Be it enacted by the Senate and General Assembly of the State of New Jersey:

1. Section 18 of P.L.1966, c. 301 (C. 27:1A-18) is amended to read as follows:

In order to conserve and improve passenger service necessary for public use now and in future years in this State, but subject to the limitations of this act, the State of New Jersey, acting by and through the agency, may enter into contracts with any rail carrier, providing for acceptance by such carrier of all or any part of the agency's determination. Prior to entering into any such contract, the agency

shall hold public hearings where it shall make known the terms and conditions of the proposed contract to interested parties and the general public. Every contract entered into pursuant to this section shall be subject to the following terms and conditions:

(a) Contracts involving expenditure of public funds for improvements to capital facilities shall require continuance of specified passenger service by the carrier for stated periods not limited to a fiscal year, and shall further require that title to such improvements shall be vested with the State, except that where public funds are expended to repair or rehabilitate existing facilities, such title to or other interest in such improvements as the carrier may have shall be the subject of negotiation between the agency and the carrier.

(b) No such contract shall provide for payments by the State to a carrier for service rendered ~~with respect to such fiscal year in excess of the loss from passenger service during the previous calendar year as shown in the determination for that fiscal year~~, in excess of the full cost of such passenger service less such setoffs and deductions as provided for in this act. Such contract may, however, provide for payments to the carrier for service rendered on a current basis during the term of the contract. If during any contract period a carrier shall realize a profit from the passenger service contracted for, which profit exceeds a return on investment of 6%, ½ of the excess shall be paid to the agency. The accounting procedures to be employed to determine the extent of any profit or loss, as the case may be, shall be a subject of negotiation between the parties to the contract.

Appendix B

(c) Every such contract shall describe the passenger service which the carrier shall be required to operate. Such description shall set forth the operation of the contracted service which shall include timetables, train consists and fair tariffs applicable to the service and any other provisions that the agency may deem reasonable.

2.

This act shall take effect immediately.

Approved and effective July 18, 1972.

Introductory Statement

This bill changes the present law to allow the commuter operating agency to compensate carriers for rail passenger service up to the full cost of providing such service rather than on the present avoidable loss basis. It also authorizes payment on a current basis rather than on a reimbursement basis. These changes are necessitated by recent Federal court rulings in connection with the reorganization of the Pennsylvania Central Railroad. It is likely that the full cost of service basis will become the standard required by the courts as a prerequisite for allowing railroads in the process of a reorganization to continue to provide passenger service.

N.J.S.A. 48:2-24

48:2-24.

No public utility shall discontinue, curtail or abandon any service without obtaining permission from the board after notice. The board may withhold permission until after hearing to determine if the discontinuance, curtailment or abandonment will adversely affect public conve-

nience and necessity. With respect to common carriers the provisions of this paragraph shall apply only to service operated in accordance with base schedules on file with the board; provided, however, that the State Highway Commissioner upon entering into a contract for passenger service pursuant to chapter 66 of the laws of 1960, as amended and supplemented, may, without approval of the board, authorize a discontinuance, curtailment, abandonment or change in passenger service, which discontinuance, curtailment, abandonment or change in service shall exist only during the term of said contract.

A public utility may terminate service for a violation of the terms of its approved tariffs on file with the Board of Public Utility Commissioners upon giving the customer at least 3 days' notice of such termination unless otherwise provided for by rules, regulations or orders of the board, except that in those situations where a hazardous condition prevails the utility may terminate service without notice.

If any public utility shall discontinue, curtail or abandon service and the board after hearing upon notice shall find and determine that service should be resumed, the board may order that service be resumed forthwith or on such date as it may fix.

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SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-742

R. D. TIMPANY, Trustee in Reorganization of the Property of the Central Railroad Company of New Jersey,

Petitioner,

v.

STATE OF NEW JERSEY, COMMONWEALTH OF PENNSYLVANIA and PENNSYLVANIA PUBLIC UTILITIES COMMISSION,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION

GEORGE F. KUGLER, JR.,
Attorney General of New Jersey,
Attorney for Respondent, State of New Jersey,
State House Annex,
Trenton, New Jersey 08625.

STEPHEN SKILLMAN,
First Assistant Attorney General,
Of Counsel and on the Brief.

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Counter-Statement of the Questions Presented

1. Does a reorganization court have the power under § 77 of the Bankruptcy Act to authorize a railroad in reorganization to discontinue rail services without first seeking the approval of the appropriate state regulatory agency or the Interstate Commerce Commission?

2. Is this case distinguishable from *Palmer* v. *Massachusetts*, 308 U. S. 79 (1939)?

Counter-Statement of the Case

On March 22, 1967 the Central Railroad of New Jersey (hereinafter referred to as the "CNJ") filed a petition for reorganization with the United States District Court for the District of New Jersey under § 77 of the Bankruptcy Act (11 U.S.C. § 205).

After the present trustee assumed office in 1971, a plan for the reorganization of the CNJ, known as the "Blueprint for Survival", was proposed. The plan contemplated the cessation of CNJ's operations in Pennsylvania, but the continuation of services, including passenger operations, within New Jersey.

On Auugst 9, 1971, a plan of reorganization predicated on the successful implementation of the Blueprint for Survival was filed with the Interstate Commerce Commission. This plan is still pending before the I.C.C.

The CNJ has now abandoned its operation in Pennsylvania but continues to operate vital freight and passenger services within New Jersey. The passenger services consist of three separate lines, two of which bring commuters into the City of Newark. There are approximately 25,000 to 30,000 riders who use these passenger services daily.

On November 22, 1972 the trustee in bankruptcy, without having made prior application either to the appropriate state regulatory agency or to the I.C.C., filed an application with the reorganization court for authority to discontinue all passenger operations of the CNJ (Third Circuit Appendix, at 6a to 43a). The petition was brought on for hearing before the reorganization court only ten business days after service of the petition upon the State (Third Circuit Appendix, at 1a, 146a).

At the conclusion of the hearing, the court rendered an oral opinion granting the trustee's application for authority to discontinue all passenger service (App. 3a to 10a). This ruling was embodied in Order No. 547 (App. 1a to 2a).

The State of New Jersey and the Commonwealth of Pennsylvania filed separate notices of appeal from this order to the Third Circuit Court of Appeals, which affirmed in a short *per curiam* opinion (App. 20a to 22a). The State and Commonwealth then filed petitions for rehearing *in banc*, which were granted (App. 23a to 24a), and the matter was reargued before the court *in banc* on May 23, 1973.* The Court of Appeals reversed Order No. 547 in an opinion holding that the reorganization court lacked the power to enter an order permitting the discontinuance of passenger service on the CNJ without complying with the requirements of federal and state law:

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* The statements in the Petition for Writ of Certiorari to the effect that the trustee was not afforded an adequate opportunity to present his case to the court *in banc* are difficult to understand. Although the court did not request the filing of an answer before granting the petition for rehearing *in banc*, *Rules* 35 and 40 of the Federal Rules of Appellate Procedure do not require such a procedure. In this case, the court probably concluded that there was no need to ask for an answer, because the arguments set forth in the State's petition for rehearing were nearly identical to those in its briefs on the merits. Furthermore, the court *in banc* heard oral argument before deciding the case. Finally, it is reasonable to assume that if the experienced counsel retained by the trustee had concluded, either after the petition for rehearing was granted or after the oral argument before the court *in banc*, that he had been deprived of an adequate opportunity to present his case, he would have sought leave to file a supplemental brief. Since he failed to do this, it is fair to assume that he was satisfied at the time with the presentation of his case.

> "[T]his Court holds that termination of passenger service cannot be ordered by the district court supervising the reorganization of a railroad under section 77, unless such termination has been approved by the appropriate agency." (App. 41a).

The court further noted that its holding

> ". . . does not preclude district courts from permitting ailing railroads to terminate services. Rather, it holds only that the reorganization court require railroads seeking termination to follow certain procedures. Adherence to such procedures is not an exercise in formalism. Rather, such adherence reflects two important concerns. First, application to the appropriate state agency preserves the balance between federal and state powers in this field. Second, administrative review assures that an agency with substantial expertise, be that agency state or federal, will provide that the appropriate amalgam of public concern for rail transport and private rights of property is achieved." (App. 42a).

The trustee then filed a petition for further rehearing *in banc*, raising for the first time the arguments now primarily relied upon in the Petition for Writ of Certiorari. This petition was denied by the Third Circuit (App. 6a to 70a).*

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* In late October, 1973, the trustee for the CNJ entered into a passenger subsidy contract with the New Jersey Commuter Operating Agency, subject to the approval of the reorganization court, for the period from July 1, 1973 to June 30, 1974. The contract, which provides for an annual subsidy of $7.9 million, contains no cancellation clause.

ARGUMENT

There is no basis for the Court to grant a Writ of Certiorari, because the Court of Appeals correctly determined that this case is squarely controlled by *Palmer* v. *Massachusetts*, 308 U.S. 79 (1939) and later cases which hold that a railroad reorganization court lacks the authority under § 77 of the Bankruptcy Act to circumvent the procedures established by Congress and state legislatures with respect to the cessation of rail services.

The reorganization court authorized the trustee of the CNJ to discontinue all of its passenger operations within the State of New Jersey without seeking the permission of either any state regulatory agency or the I.C.C.*

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* In the State of New Jersey, if a passenger subsidy contract is in effect, an application for any change in service must be made to the Commuter Operating Agency in the Department of Transportation. N.J.S.A. 27:1A-24. If the expenditure of public funds is not involved, an application must be made to the Board of Public Utility Commissioners. N.J.S.A. 48:2-24.

If a rail line operates from a point in one state to a point in another state, then the railroad may disregard the requirements of state law and apply directly to the I.C.C. for permission to discontinue the service pursuant to 49 U.S.C. § 13a(1). If a discontinuance of service rises to the level of an "abandonment" within the meaning of § 77(o) of the Bankruptcy Act (11 U.S.C. § 205(o)) and § 1(18) of the Interstate Commerce Act (49 U.S.C. § 1(18)), the application also may be made directly to the I.C.C. *Colorado* v. *United States*, 271 U.S. 153 (1926). If the service operates entirely within a single state, then the railroad may petition the I.C.C. for permission to discontinue the service only after the state agency has denied such relief pursuant to 49 U.S.C. § 13a(2).

Although there has been some controversy as to which of these procedures would be applicable, what *Palmer* holds is that the reorganization court lacks the authority to override the applicable administrative procedure, regardless of which one is applicable.

In so doing, as the Court of Appeals properly held, it exceeded the powers of a reorganization court under § 77 of the Bankruptcy Act as construed in *Palmer* v. *Massachusetts*, 308 U. S. 79 (1939).

In *Palmer*, the Old Colony Railroad in Massachusetts had suffered nearly $6 million in losses in a two-year period. This was attributable solely to losses in passenger service, since the freight continued to make money. The railroad therefore applied to the State Public Utility Commission for permission to discontinue certain passenger trains. When the Commission failed to issue a final decision within six months, the railroad petitioned the reorganization court for permission to discontinue those services. The reorganization court granted this relief, concluding that the failure to allow discontinuance "would result in confiscation." On appeal, the Court of Appeals reversed this discontinuance order on the grounds that it was in excess of the reorganization court's authority. *Converse* v. *Massachusetts*, 101 F. 2d 48 (2nd Cir. 1939). On appeal this Court affirmed in an opinion which squarely held that a reorganization court lacks the power to authorize the discontinuance of rail service without complying with the requirement of applicable state and federal laws:

> "In view of the judicial history of railroad receiverships and the extent to which § 77 made judicial action dependent on approval by the Interstate Commerce Commission, it would violate the traditional respect of Congress for local interests and for the administrative process to imply power in a single judge to disregard state law over local activities of a carrier the governance of which Congress has withheld even from the Interstate Commerce Commission, except as part of a com-

> plete plan of reorganization for an insolvent road." *Palmer* v. *Massachusetts,* 308 U. S. at 88.

Subsequent to *Palmer,* in cases involving matters within the jurisdiction of the I.C.C., the Court has reaffirmed its holding that Congress did not confer power on a railroad reorganization court to preempt the jurisdiction of state and federal regulatory agencies with respect to the cessation of rail service. *Smith* v. *Hoboken Railroad, Warehouse and Steamship Connecting Co.,* 328 U. S. 123 (1946); *Thompson* v. *Texas Mexican R. Co.,* 328 U. S. 134 (1946). See also *New Haven Inclusion Cases,* 399 U. S. 392 (1970). These later cases have emphasized that Congress intended the I.C.C. to play the central role in railroad reorganizations in order to preserve the nation's rail transportation system. In the *New Haven Inclusion Cases, supra,* the Court said:

> "Central to the statutory objective that the reorganized company should, if at all possible, emerge as a 'living, not a dying * * * enterprise', . . . is the understanding that 'a railroad [is] not like an ordinary insolvent estate.' *Palmer* v. *Massachusetts,* 308 U. S., at 86. . . . To the traditional equity jurisdiction of the bankruptcy court, § 77 adds the oversight of the Interstate Commerce Commission, the agency 'specially charged with the public interest represented by the transportation system.' *Ibid.* The statute contemplates that '[t]he judicial functions of the bankruptcy court and the administrative functions of the Commission [will] work cooperatively in reorganizations.' *Warren* v. *Palmer,* 310 U. S. 132, 138 . . .
>
> "In structuring the cooperative endeavor of agency and court, Congress 'placed in the hands of

> the Commission the primary responsibility for the development of a suitable plan' for the debtor railroad." 399 U. S. at 431.

Thus, it is the I.C.C., not the reorganization court, which has been given the primary responsibility to determine which rail services must be continued as part of a plan of reorganization. If the I.C.C. refuses for any reason to approve a plan of reorganization, including an inability to find that the plan "will be compatible with the public interest," a reorganization court may dismiss the reorganization proceedings. 11 U.S.C. § 205(e), (g). See *In re New York, New Haven and Hartford Railroad Co.*, 289 F. Supp. 451, 459 (D. Conn. 1968); *In re Wyoming Ry. Co.*, 94 F. Supp. 371 (D. Wyo. 1950). However, the holding of *Palmer* is that a trustee may not simply by-pass statutorily prescribed procedures and ask the reorganization court to take over the functions of the I.C.C. and state regulatory agencies.

The grounds on which the petitioner attempts to distinguish *Palmer* from this case are lacking in substance.

The assertion that *Palmer* is inapplicable because the State consented to the reorganization court hearing this matter is without support in the record. The alleged statement of the Commissioner of Transportation* by

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* The sole testimony relied upon for this claim is the following statement by the trustee:

> "These discussions continued until mid September. And in mid September Commissioner Kohl, as I understood him, suggested that I should go to court. And when I did go to court on the Wednesday before Thanksgiving, I tried to call him. I couldn't reach him and I sent him a letter, saying: In view of what you said before, I have taken this action." (Third Circuit Appendix, at 146a).

which the State is claimed to have consented to the proceedings amounted to nothing more than the familiar, "if you don't like our offer, take us to court," which often punctuates the unsuccessful termination of negotiations. Furthermore, the petitioner never advanced the contention that a waiver of any objection to the jurisdiction of the reorganization court should be implied from the Commissioner's alleged remark either before the reorganization court or in the Court of Appeals, except in his petition for further rehearing, which was filed *after* the Court of Appeals had rendered its final decision. This not only indicates that the notion the State had waived its objections to the jurisdiction of the reorganization court was an afterthought of appellate counsel, but also, under well established principles governing review by this Court, should preclude the petitioner from now raising the point. *Neely* v. *Eby Construction Co.*, 386 U. S. 317, 330 (1967).

The assertion that the State is barred from objecting to the lack of jurisdiction of the reorganization court because the attorney handling the matter failed to raise the point early enough is similarly lacking in substance. It is important to note in this connection that the motion for discontinuance was served upon the State the Wednesday before Thanksgiving, only ten business days before it was brought on for hearing (Third Circuit Appendix, at 1a, 146a). The motion contained no indication of any statutory authority for the reorganization court to grant the relief requested. Furthermore, the only brief submitted on behalf of the trustee was not served upon the State until after the hearing on the petition had begun (Third Circuit Appendix, at 65a). This procedural blitzkrieg not only stands in striking contrast to the careful and deliberate consideration accorded

passenger discontinuance applications by the I.C.C. and New Jersey regulatory agencies, but also in fairness should preclude the trustee from claiming that the citizens of New Jersey may be denied the protection of the procedures established by Congress and the New Jersey Legislature for the cessation of passenger services simply because the attorney handling the matter was not able to fully research the law before the hearing. Moreover, this contention too was raised for the first time in the petition for further rehearing *in banc* and thus the petitioner should be barred from now raising the point. *Neely* v. *Eby Construction Co., supra.*

In any event, *Palmer* clearly holds that a railroad reorganization court lacks the power under § 77 of the Bankruptcy Act to permit the discontinuance of passenger services, without the trustee first complying with the applicable requirements of state and federal laws. It is well established that a challenge to the authority of a court to entertain jurisdiction over a matter may be raised at any time. *Gutierrez* v. *Waterman Steamship Corp.*, 373 U. S. 206 (1963); *McGrath* v. *Christianson*, 340 U. S. 162 (1950). Therefore, even if it could be fairly said, notwithstanding the circumstances described above, that the State failed to object in a timely fashion to the lack of authority of the reorganization court to permit a discontinuance of passenger service on the CNJ, this would not preclude raising the point on appeal.

Lastly, the petitioner suggests that *Palmer* is not controlling because the discontinuance order here was based on a finding, absent in *Palmer*, that there had been an unconstitutional taking of the debtor's property. In fact, exactly the opposite is true; whereas the reorganization court in *Palmer* expressly found that "failure to grant

the relief asked would result in confiscation," *Converse* v. *Massachusetts, supra,* 101 F. 2d at 50, the findings of the CNJ reorganization court on this question were, at best, equivocal. In any event, the holding in *Palmer,* reaffirmed by the Court of Appeals opinion herein,* is that the reorganization court lacks the power to entertain an application for the discontinuance of rail service even if it is based on allegations of an unconstitutional taking.

One probable reason for the congressional decision not to confer this power upon reorganization courts was its awareness that the mere fact that a railroad has been losing money, even for a lengthy period of time, does not necessarily mean that the continuation of its operations will result in an unconstitutional taking of property. *Cf. Fort Smith Light & Traction Co.* v. *Bourland,* 267 U. S. 330 (1925). The efforts of the state and federal agencies may produce a plan by which management efficiencies, reduction in labor costs, merger with another railroad, or the discontinuance of certain selected serv-

* The first point of the petition seeks to elevate a single sentence observation at the conclusion of the Third Circuit opinion, relating to the findings of the lower court as to the existence of an unconstitutional taking, into the holding of the court, thereby obscuring the conclusion that *Palmer* is controlling. The observation was made as a postscript to the main part of the opinion to show that the findings of the court below did not provide a proper foundation for the legal arguments advanced by the petitioner. The opinion does not state that a railroad reorganization court, which is a statutory court, could acquire additional powers beyond those conferred upon it by § 77 of the Bankruptcy Act if such findings had been made, but only that there was no question before it as to the constitutionality of § 77 as construed in *Palmer.*

ices,* may enable a railroad which has long been operating at a loss to resume profitable operations.** The complexity of the analysis which must be undertaken before it can be said that the continuation of rail services will amount to an unconstitutional taking of property was well stated by Judge Anderson in his opinion in *In re New York, New Haven and Hartford Railroad Company, supra*:

> "The extent to which the constitutional minimum of value of property rights to which the bondholders are entitled . . . may properly be invaded in the public interest to keep railroad operations going pending a solution of the problem of reorganization, is hardly a matter which can be determined with mathematical precision. It involves a consideration of the amount and nature of the Railroad's obligations, the seriousness of adverse consequences to the public if service were terminated, the rate of losses and the feasibility of possible solutions." 289 F. Supp. at 459.

In declining to grant reorganization courts the power to allow discontinuances of rail service, Congress no doubt acted in full realization of the complexity of the consid-

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* In fact, after the original decision of the Third Circuit in this matter, the trustee filed a petition with the New Jersey Commuter Operating Agency for authority to discontinue passenger service on the smallest of the CNJ's three lines, contending that that particular line operates at a heavy loss and is not required by public convenience or necessity.

** It is interesting to note in this connection that whereas the CNJ's income and expense statements for the first eight months of 1972 indicated net losses of $6,760,047., the net losses for the first eight months of this year have been $1,560,322., which is only one-fourth of what the losses were a year ago.

erations that come into play in making such a determination and the consequent desirability of allowing agencies with expertise in the field to be given the first opportunity to review an application for such relief.

It is impossible to quarrel with the petitioner's observation that "[t]he railroads in the northeast are in crisis." (Petition for Writ of Certiorari, p. 11). However, the solution to this crisis does not lie in the precipitous termination of vital rail services which provide transportation for commuters into the nation's major urban centers. Rather, every effort must be made, either through greater efficiency in management, appropriate reductions in the work force and the discontinuance of unnecessary services by means of consolidation and merger or through the enactment of comprehensive new legislation such as is now under consideration in Congress, to preserve the vital rail services now being performed by these railroads. The primary responsibility for protecting the public interest in rail service has been vested by existing legislation in the I.C.C. and state regulatory agencies, and Congress has withheld power from reorganization courts to circumvent these procedures. This was the square holding of *Palmer* v. *Massachusetts* and there is therefore no unsettled question of federal law posed by the petition which would warrant plenary review by the Court.

CONCLUSION

It is respectfully submitted that for the foregoing reasons the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

GEORGE F. KUGLER, JR.,
Attorney General of New Jersey,
Attorney for Respondent, State of New Jersey.
By: STEPHEN SKILLMAN,
First Assistant Attorney General.

STEPHEN SKILLMAN,
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Of Counsel and on the Brief.

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BRIEF IN OPPOSITION

ISRAEL PACKEL, *Attorney General*
Capitol Annex
Harrisburg, Pennsylvania 17120

MICHAEL Von MOSCHZISKER,
Deputy Attorney General
206 State Office Building
Philadelphia, Pennsylvania 19130

GORDON P. MacDOUGALL,
Spec. Asst. Attorney General
705 Ring Building
Washington, D.C. 20036

PHILIP P. KALODNER, *Counsel,*
EDWARD MUNCE, *Assistant Counsel,*
ALFRED N. LOWENSTEIN,
Assistant Counsel,
Pennsylvania Public Utility Commission
118 North Office Building
Harrisburg, Pennsylvania 17120

Attorneys for Respondents, Commonwealth of Pennsylvania and Pennsylvania Public Utility Commission,

December, 1973

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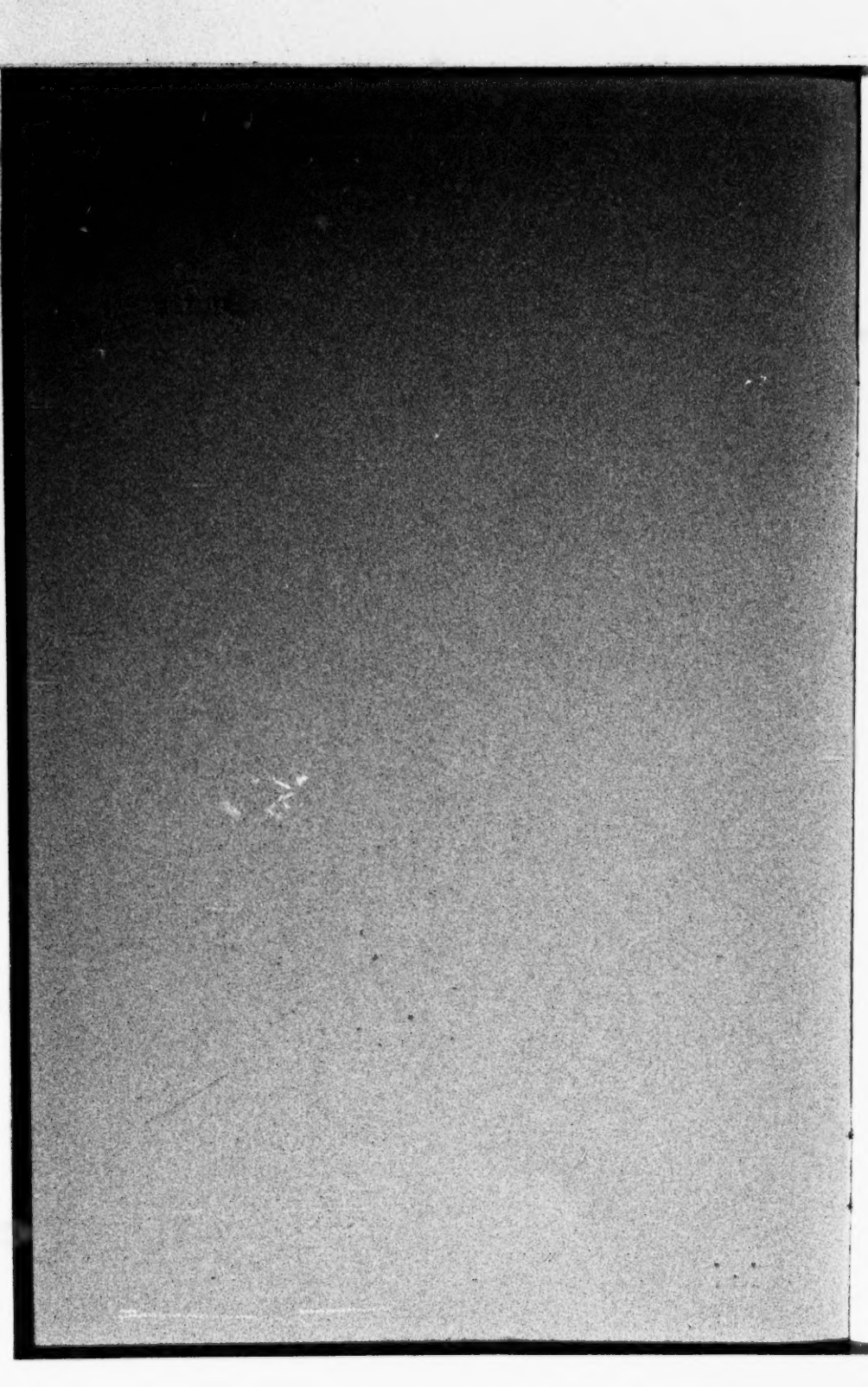

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Respondents.

BRIEF IN OPPOSITION

Commonwealth of Pennsylvania and Pennsylvania Public Utility Commission, respondents, submit this brief in opposition to the petition for *certiorari.*

The question presented below by Pennsylvania, and decided by the Third Circuit, is:

> Whether a railroad reorganization court may direct the discontinuance of all passenger train service without approval from the involved State regulatory agencies or the Interstate Commerce Commission.

Pennsylvania's interest in the complete discontinuance of passenger train service by The Central Railroad Company of New Jersey (CNJ), is the operation of two pairs of commuter trains on weekdays in both directions between Philadelphia, Pa. and Newark, N.J. These four trains operate in through equipment with Reading Company. The trains are operated as Reading trains between Philadelphia, Pa. and Bound Brook, N.J., and as CNJ trains between Bound Brook, and Newark, N.J. However, as far as the passenger is concerned, a single train operates between Philadelphia, Pa. and Newark, N.J.[1] At Newark, other railroads can be utilized for travel to and from New York, N.Y.

The CNJ reorganization court directed CNJ's trustee to summarily discontinue all passenger train service, without resort to either State or federal regulatory agencies. The U.S. Court of Appeals reversed, relying upon *Palmer v. Massachusetts,* 308 U.S. 79 (1939).

ARGUMENT

The decision below is correct, and no issue warranting plenary review is presented.

The reasoning of *Palmer v. Massachusetts, supra,* is sound today. A railroad reorganization court is "not qualified" to pass upon the discontinuance of train service:

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[1] The single through train operation between the two railroads is similar to that before the court in *United States v. Chicago,* 400 U.S. 8 (1970).

> "It has become the settled social policy both of the states and the nation to entrust the type of public interest here in question to expert administrative agencies because of 'the notion', as Judge Learned Hand pointed out below, 'that a judge is not qualified for such duties'." 308 U.S. at 86.

Moreover, Congress in 1958 accelerated passenger train discontinuance proceedings, by enactment of Section 13a to the Interstate Commerce Act. If a train operates wholly within one state, the jurisdiction of the I.C.C. may be invoked after 120 days. *New Jersey v. New York, S. & W. R. Co.*, 372 U.S. 1 (1963); *Southern R. Co. v. North Carolina*, 376 U.S. 93 (1964). A train operating from a point in one state to a point in another state might be discontinued on as little as 30 days' notice. *New Jersey v. United States*, 168 F. Supp. 324 (D.N.J. 1958), aff'd., 359 U.S. 27 (1959).

CNJ's assertion of constitutional arguments is baseless. The reorganization court made no findings of unconstitutionality (Pet., 3a-10a), and the Court of Appeals has not precluded future developments on this score. (Pet., 43a).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

ISRAEL PACKEL, *Attorney General*
Capitol Annex
Harrisburg, Pa. 17120

MICHAEL Von MOSCHZISKER,
Deputy Attorney General
206 State Office Building
Philadelphia, Pennsylvania 19130

GORDON P. MacDOUGALL,
Special Assistant Attorney General
705 Ring Building
Washington, D.C. 20036

PHILIP P. KALODNER, *Counsel*
EDWARD MUNCE, *Asst. Counsel*
ALFRED N. LOWENSTEIN,
Assistant Counsel
Pennsylvania Public Utility Commission
118 North Office Building
Harrisburg, Pennsylvania 17120

Attorneys for Respondents, Commonwealth of Pennsylvania and Pennsylvania Public Utility Commission.

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